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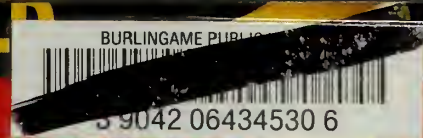
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Business Week

2006 January 9



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BusinessWeek

FRIDAY 9, 2006

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Intel Inside Out

How it's
shaking off
the Andy
Grove era

CLIFF EDWARDS (P. 46)



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More and more executives are using their ma

Which begs the question: What's a

mailstream

THE FLOW OF MAIL, documents and packages has become increasingly diverse, containing everything from bills and e-statements to direct mail and goods like DVDs.

In fact, it has become so complex that some key players have coined a new term, the mailstream, to better describe this dynamic amalgam of data, processes, and technology.

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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China's New Architectural Wonders

As part of an ongoing series on the world's most amazing architecture, our Innovation & Design channel looks at the **building boom in China**. Its insatiable demand for landmark structures has attracted star architects from all over the world. The resulting cutting-edge designs, from diaphanous theaters to water-cooled buildings, are featured in a **slide show**. And in a Q&A, renowned **Beijing architect Yung Ho Chang** says the goal isn't pagoda-shaped skyscrapers—it's buildings that affect people's daily lives



Oil Predictions: Expect Slippery Turf

What price changes will 2006 bring? Maybe a 7.5% increase—or a steep drop, depending on who's talking. One key factor: The supply from non-OPEC countries, which failed to grow at all in 2005



Tough Choices Ahead For Adobe

After the Macromedia merger, CEO Bruce Chizen faces a major challenge: How to keep scoring with the existing software product lines while breaking fresh ground in the market for mobile devices



Is the U.S. Really Falling in Engineering?

There's a perception—perhaps unfounded—that graduation rates in India and China dwarf those in the U.S., scaring off American engineering students



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"I'm not sure this is a hobby for him. I think this is his next big idea."

—John Logsdon,
Space Policy Institute, to
The Seattle Times on
Amazon.com CEO Jeff Bezos'
plan for a rocket complex

EDITED BY DAN BEUCKE

SPORTS WATCH GET INTO THE ACTION IN YOUR CELL



NEED TO SEND A WORD to
Bron? Soon it may be as
simple as punching out a text
message. Several pro hockey
and basketball teams are
thinking of letting fans send
team cheer or even a wed-
ding proposal to the score-
board from their cell phones.

Atlanta's **FanDrive Media** has talked with NHL and NBA teams interested in the technology. On Dec. 5, FanDrive Media showed off cell capabilities at a New York Rangers-Minnesota Wild hockey game at **Madison Square Garden**. Between periods, fans could "talk to the Rangers" by sending text messages (through a moderator) to the scoreboard.

Messaging is just one way for fans to use phones. In coming weeks, the **Air Canada Centre** in Toronto will let them pick songs at Raptor basketball and Maple Leaf hockey games. They will also play trivia games and see answers on the scoreboard. Some teams might charge 50¢ or so for services; others would offer them free and use phone contacts to create customer lists. —Mark Hyman



AIRLINES

Branson Hits U.S. Headwinds

NOW THAT BRITISH BILLIONAIRE Richard Branson has finally laid out his plans for a low-cost U.S. airline, he is sparking a trans-continental lobbying storm. In December, Branson and a group of American investors sought U.S. Transportation Dept. approval to launch **Virgin America** out of San Francisco. Branson says it would be 75% owned by U.S. investors and 25% owned by British investors, including Branson's **Virgin Group** companies, and thus qualify as a domestic carrier under federal law.

Now, Virgin America is snarled in a long-running battle over U.S. airlines' access to Europe, particularly London's Heathrow Airport. **Continental Airlines**, which wants expanded landing rights at Heathrow, is leading the charge. With help from other U.S. carriers and unions, it has buried the Transportation Dept. in paper questioning Virgin's financing and has asked the Bush Administration to wrest more detail about Virgin's funding and licensing agreements with British and European companies. Meanwhile, U.S. carriers, moving to head off future threats, have persuaded lawmakers to introduce legislation blocking Transportation plans to relax foreign-ownership rules.

—Lorraine Woellert

THE BIG PICTURE

WE'RE NO. 1 Toyota should overtake General Motors as the world's largest carmaker in 2006. Other notable No. 1/No. 2 shifts got less attention:

COKE/PEPSI In December, Pepsi seized the crown of largest cola stock market cap for the first time

VERIZON/AT&T By purchasing AT&T for \$16 billion and taking its name, SBC in November replaced Verizon as the largest U.S. phone company by sales

PIMCO/WESTERN ASSET MANAGEMENT WAMCO passed PIMCO in bond assets under management in December, when parent Legg Mason bought Citigroup's money management group

FIDELITY MAGELLAN/FIDELITY CONTRAFUND Contrafund became Fidelity's largest fund by assets under management in September, surpassing Magellan

AMGEN/GENENTECH Genentech raced ahead of Amgen in market cap for several weeks in mid-2005; now they're neck and neck

Source: BusinessWeek

THE YEAREND QUIZ

SHARPEN YOUR PENCILS; it's time to find out who was paying attention in 2005. Blogs hit it big, old media stumbled, and emerging-market stocks became stars. One celebrity CEO walked away from trial a free man, another got major jail time, and a third left prison for newfound fame. See if you can sort it all out.

1 Which two of these techies got into a tiff over who invented podcasting?

- A Steve Jobs
- B Dave Winer
- C Caterina Fake
- D Adam Curry
- E Rob Glaser

5 What Internet company launched a high-profile search in 2005 to hire a new chief?

- A Yahoo!
- B Google
- C eBay
- D Salon.com

8 Match the aging rock legends with the companies that used them or their songs in 2005 ad campaigns.

- A Bob Dylan
- B Paul McCartney
- C Rolling Stones

13 What was the first sentence of Maureen Dowd's takedown column on her then-colleague, *The New York Times* reporter Judith Miller?

- A "I write this with great sadness."
- B "I've always liked Judy Miller."
- C "So this is how all those powerful men ultimately treat you."
- D "Was Rummy too chummy?"

- 1 Fidelity Investments
- 2 Kaiser Permanente
- 3 Ameriquest Mortgage

9 How many years must former WorldCom CEO Bernie Ebbers serve in prison?

- A 2 to 5
- B 10
- C 25

14 Which of the following products was not announced by Donald Trump in 2005?

- A Trump University
- B Trump "super-premium" vodka
- C Trump cuff links
- D Trump Airline

15 How much will a company have to pay for the title "official sponsor of Mardi Gras 2006"?

- A \$10,000
- B \$500,000
- C \$2 million
- D \$10 million

16 The country whose stock market rose the most through Nov. 29 in the Morgan Stanley Capital International Emerging Markets Index is:

- A Egypt
- B India
- C Thailand
- D Poland

2 What was the name of the 92-foot yacht seized temporarily by the feds from former HealthSouth CEO Richard M. Scrushy before his trial and exoneration?

- A Monkey Business
- B Chez Soiree
- C Healthy Livin'
- D Dallas County Line

6 Which of the following carmakers did not introduce a new hybrid gas-electric vehicle in 2005?

- A Toyota
- B Ford
- C Nissan
- D Honda

7 According to Technorati, the number of blogs is doubling every...

- A Year
- B Five months
- C Five weeks
- D Five minutes

3 Who or what is Mini-Microsoft?

- A A new one-man off-Broadway play
- B A venture fund to create the next software powerhouse
- C Google's secret strategy to topple Microsoft
- D An anonymous employee blogger critical of Microsoft

4 Which airline was NOT in Chapter 11 in 2005?

- A American
- B United
- C Delta
- D Northwest
- E US Airways

10 Warren Buffett was speaking of which recent Berkshire Hathaway purchase when he said he made a mistake not making a major investment in the late 1990s?

- A Diageo
- B Wal-Mart
- C Wells Fargo
- D Anheuser-Busch

11 What natural ingredient is in short supply and complicating plans to expand production of the flu-fighting drug Tamiflu?

- A Golden lion tamarin
- B Tamarack tree
- C Star anise
- D Ambergis

12 After being seen at a yoga class and driving around, Martha Stewart's home confinement was extended by...

- A 16 days
- B Three weeks
- C Three months
- D Five months



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HOT DATES

Events to watch for in the New Year

JANUARY



The federal criminal trial of former **ENRON** Chairman Ken Lay and CEO Jeff Skilling is set for Jan. 30 in Houston. Having agreed to a plea deal, Chief Accounting Officer Richard Causey will help the feds.

JANUARY



After 18 years as Federal Reserve Chairman, **ALAN GREENSPAN** attends his final meeting of the Fed's Open Market Committee on Jan. 31. Ben Bernanke takes over.

FEBRUARY



Feb. 1 is the deadline for investment advisers for **HEDGE FUNDS** to register with the SEC if they have at least \$30 million in assets and 15 U.S. clients.

MARCH



AL JAZEERA plans to launch its new TV service, Al Jazeera International, in Europe, Asia, and North America, by the end of the first quarter.

APRIL



SANDY WEILL retires as chairman at the Citigroup annual meeting. Weill built the company using serial acquisitions. His replacement has yet to be named by the Citi board.

MAY



TIME WARNER holds its annual meeting, where billionaire investor Carl Icahn will likely face off with the board in an all-out proxy fight.

OCTOBER



GENERAL MOTORS unveils new Chevy Silverado and GMC Sierra pickup trucks, key vehicles in its comeback campaign. GM's first redesigned SUV, the Chevy Tahoe, goes to dealers in early January 2006.

OCT./NOV.



Our best guess for when Microsoft releases **WINDOWS VISTA**, the first Windows update in five years. Less audacious than once planned, Vista should still break sales records.

NOVEMBER



AIRBUS is scheduled to deliver its first A380 double-decker megaplane to Singapore Airlines, upping the stakes in its battle with Boeing for global dominance.



With 244 hp, leather seats and available navigation system, you'll be on the right track. The Accord EX V-6 Coupe.

honda.com 1-800-33-Honda 6-speed model shown. ©2005 American Honda Motor Co., Inc.



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Some of [my sorority sisters have] become addicted to MySpace... I will not allow the same thing to happen to me."

—Melissa Sharp
San Diego



WHAT'S NEXT FOR GENERATION@?

"THE MYSPEACE generation" (Cover Story, Dec. 12) brings alive the realities of consumer-generated media, today's prime media real estate. However, it does not address the fact that nearly 40% of the under-25 population is Asian, Latino, or black. These consumers, largely born in America, hop in and out of various cultures with the same dexterity as they jump in and out of media spheres for entertainment, research, shopping, or advocating a cause they truly believe in. While they do speak English, they also simultaneously gobble up math and reggaethon, kimchee and Bollywood, based on their sociodemographic and cultural orientation. With a cultural fluency that is matched by their technological savvy, this dynamic generation continues to challenge those marketers who still operate from segmentation templates.

—Rupa Ranganathan
Ethnic Strategist & Senior Vice-President
Strategic Research Institute
New York

I LIVE IN A sorority house with 40 of my sorority sisters. MySpace.com is all the

rage. Some of the girls become addicted to MySpace. I've seen it suck them in, and I will not allow the same thing to happen to me. The only way to do this is to abstain from using it altogether. Whoever thought something like this would be multimillion-dollar hit? It makes me wonder what could possibly be next in this Generation@.

—Melissa Sharp
San Diego

THE MERGER BANDIT IN THE CORNER OFFICE

IN "FAT MERGER payouts for CEOs" (News: Analysis & Commentary, Dec. 12), there's a quote: "I just think of it as price you have to pay" to get a target company's CEO to submit to being taken over. Sounds like bribery, which is illegal.

—Ernie Jelline
Cherry Hill, N.J.

IT IS NOT THE SELLER of a business who creates value but the acquiring company. Usually there are two possible reasons that the business is being sold: one, the enterprise is failing and cannot compete; or two, top management is selling a successful enterprise, perhaps to the detriment of the company.

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CORRECTIONS & CLARIFICATIONS

n "Microcredit missionary" (Voices of Innovation, Dec. 26), GrameenPhone is 51% owned by Norway's Telenor, not Nortel.

ent of shareholders. In either of these situations the CEO has not fairly earned the amounts you report. These dollars could have been paid to the shareholders. Since the CEO is making the deal, he is in a position to place his interests above those of the shareholder. Someone else must represent shareholders. If the board of directors won't do it, perhaps a federal action on these payouts should be assessed—as much as 75%.

—William McKee
Whitney, Tex.

AMERICAN EXPRESS promises Kenneth I. Chenault a \$73 million takeover payout "to help keep employees focused on their jobs." If \$25 million would not keep Chenault focused on his job, perhaps American Express should divert that million or so to treatments for Attention Deficit Hyperactivity Disorder.

—Paul Manogian
Aurora, Colo.

INCENTIVES, SUBSIDIES, AND NATURE ALL AFFECT WARMING

THE RACE AGAINST climate change" Special Report, Dec. 12) offers the strongest evidence and most convincing data I have seen supporting the role of private enterprise in environmental issues. It makes obvious the non-need for government regulation and the benefits of economic incentives.

—Carl Otto
Palo Alto, Calif.

HYDROGEN IS NOT an alternative to fossil fuels. It takes energy to create hydrogen. Please stop repeating President George W. Bush's ridiculous notion that hydrogen somehow reduces the use of fossil fuel. Hydrogen does have an important role in future energy production: as a transport and delivery medium for renewable energy such as wind power. The problem is that the lion's share of subsidies and research and development, by some accounts 90%, still goes to fossil fuel and nuclear (not renewable) energy.

—Christopher Swartley
UPC Wind Management
Newton, Mass.

HERE HAVE BEEN six changes from cold to warm and back again to cold in

the past 12,000 years alone since the peak of the last "ice age" period 18,000 years ago. Ice ages are caused by the natural inertial changes of the earth's inclination and orbit around the sun. The attribution of the natural changes to "man-made CO₂" is a scientific error corrected back in 1994 by the famous originator, James E. Hansen, himself.

—George W. Stroke
Munich

HOW VISA PROTECTS ITS PREPAID CARDHOLDERS

TRANSACTIONS PERFORMED with any Visa International card produce a set of data with identifying transaction dates, times, places, types of goods purchased, and other crucial information ("Prepaid Cards: Candy for criminals?" News: Analysis & Commentary, Dec. 12). Prepaid card issuers and processors utilize sophisticated transaction monitoring systems to detect unusual and fraudulent activities, including transactions that may be related to money laundering. If an issuer determines that a prepaid card is being used for unlawful activity, the issuer has the capacity to make the card inoperable almost immediately. Additionally, Visa requires banks that issue prepaid cards as reloadable products to obtain customer identifying information and to be in full compliance with all applicable state and federal laws. A Visa card provides a far more protected means of payment than the alternative traditionally used to fund unlawful activities: cash. Visa and its member financial institutions take their anti-fraud responsibilities quite seriously, and we are proud of our record in this area.

Todd Brockman
Senior Vice-President, Prepaid Products
Visa USA
San Francisco

How to reach BusinessWeek

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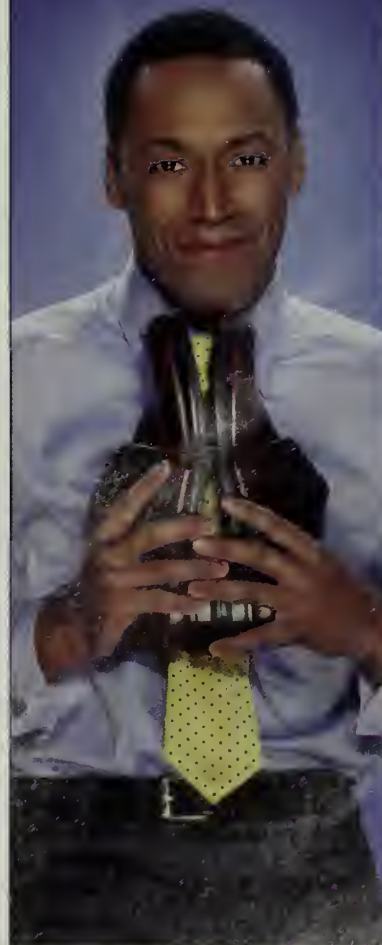
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Technology&You

BY STEPHEN H. WILDSTROM

If BlackBerry Gets Smushed...

What are you going to do if you wake up one morning and discover that your indispensable BlackBerry e-mail service has stopped, shut down by the judge hearing a patent infringement case? While I still think this is unlikely, it could happen. The good news is that there are some pretty decent alternatives for companies and individuals.

Research In Motion controls BlackBerry hardware, software, and the service that links them (though software that lets other handhelds work with BlackBerry mail is slowly becoming available). Thanks to this level of integration, BlackBerry devotees get an experience with few glitches. But, like Apple Computer customers, they depend on one vendor—so going with an alternative requires both a new service and new hardware.

If you or your company decides to switch, there are a number of hardware approaches to choose from—and you may not need to change your current carrier. The most popular is the Palm Treo 650, which Cingular, Sprint, and Verizon Wireless sell for \$200 and up with a service contract and after rebates. You can also check out some keyboard-equipped Pocket PCs, including the Hewlett-Packard iPaq hw6515 (\$450 from Cingular Wireless), the Sprint PPC-6700 (\$419), and the Samsung SCH-i730 (\$600 from Verizon).

FOR CORPORATIONS, the major attraction of the BlackBerry hardware-service combo is the automatic delivery of e-mail to handheld devices. (The smaller group that uses BlackBerrys to retrieve mail from Internet accounts would not be affected by a shutdown of RIM's service.) There are two ways to get corporate mail into a BlackBerry handheld: a do-it-yourself version that relays messages from Microsoft Outlook on your desktop and a back-end system that uses BlackBerry Enterprise Server (BES) to exchange mail and corporate data between BlackBerrys and your office computer systems.

The best alternative for these corporate deployments is GoodLink from Good Technology. It provides access similar to BlackBerry but on a variety of devices, including Treos, an assortment of Windows Mobile Pocket PCs and Smartphones, and the new Nokia E91. Despite the similarity of the services, Good Technology does not face legal problems because it has licensed the disputed technology from patent holder NTP.

A GoodLink or BES installation can cost many thousands of dollars. Smaller businesses looking for a simpler and less



There are some good alternatives to the beloved e-mail service

expensive solution might consider the Sproqit Workgroup Edition from Sproqit Technologies, starting at \$1,000 for five users. Sproqit is relatively easy to install and manage and provides many of the same services as Good or BlackBerry. A personal version that runs on the desktop costs \$8.95 a month.

In addition to GoodLink and Sproqit, just about every wireless carrier offers services that can push e-mail, contacts, and calendar data from your desktop to Palms, Pocket PCs, and Smartphones. For example, Sprint offers a personal version of its Business Connection service for a \$5 monthly surcharge on a data plan for a variety of wireless devices.

Microsoft has an angle on this as well, based on its corporate Exchange mail system. Soon, Exchange will include automatic wireless synchronization of mail, contacts, and calendar. The difficulty is that it requires the latest version of Exchange, which relatively few customers run yet. Furthermore, it works only with Pocket PCs and Smartphones running the latest version of Windows Mobile software, and some features won't work until an update to the handheld software becomes available in a few weeks.

BlackBerry continues to be a wonderful way to get mobile e-mail. But should worse come to worst, or if you are simply tired of having all your eggs in one basket, it's good to know there are other choices. ■

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Bionic Sensation

DR. TODD A. KUIKEN pulls up a video clip on his computer. A department director at the Rehabilitation Institute of Chicago and an associate professor at Northwestern University's medical school, Kuiken is sitting in his 11th-floor office. On the screen, the mini-movie shows a man in a white T-shirt putting on a bright-yellow trucker's cap.

"Yo," he says and bows after snuggling the cap on his head.

Big deal, huh? Well, yes, it is. The man, a former power-company worker named Jesse Sullivan, has no arms. His limbs were destroyed to the shoulder when he accidentally touched a high-voltage line in 2001, so he must now maneuver a computerized arm wired to nerve stumps in his chest and controlled, down to each fingertip, entirely by electrochemical impulses. In other words, by thought. Kuiken swivels at his desk, as if to take a bow himself. And a bow would be well-deserved: Sullivan's custom-made prosthesis—the world's first brain-powered arm—is Kuiken's brainchild.

Bionic humans have long been the stuff of science fiction. Kuiken, 45, remembers watching *The Six Million Dollar Man* on TV as a teenager before heading off to the University of Idaho in 1978 to study mechanical engineering. Even now, despite advances in robotics and neurology, most people who have had at-the-shoulder amputations use a mechanical device made of straps and cables that dates to the Civil War.

Kuiken set out to better meld man and machine 25 years ago while simultaneously pursuing his medical degree and a PhD in biomedical engineering at Northwestern University. His dual interests turned out to be critical, allowing him to succeed where a narrowly focused engineer or doctor would have come up short. Previously, researchers had shown that nerves could be hard-wired to electronic devices. But myoelectric impulses—the stop-and-go signals of the body's muscle system—are often too faint for computers to interpret accurately. Kuiken, a lifelong tinkerer who built treehouses and his own Soap Box Derby racer as a boy, found a way to amplify those charges, working with lab rats in the 1980s.



Kuiken's training in engineering and medicine helps him build some of the best robotic limbs

Although this research took years, it turned out to be a snap compared to what followed. Collaborating with Allen Taflove, a Northwestern professor of electrical and computer engineering, Kuiken had to decode the muscular signals to differentiate between one telling the forearm to move, for example, and another ordering the fingers to close. They attached 115 electrodes to nerves that had been rerouted in Sullivan's chest. Then they asked him to perform 26 different motions so they could learn the exact combination of impulses for each move. Kuiken also needed a semiconductor-packed arm that could follow these directions in real time. For that, he turned to Liberating Technologies Inc., a prosthetic-device maker in Holliston, Mass. Finally, in 2002, Kuiken was ready to test a

bionic arm on a person—and there was Sullivan, already in the Rehabilitation Institute after his double amputation.

Today, Sullivan can do many of the things he did before, though not as naturally: He dresses and feeds himself, shaves, uses scissors, vacuums, and works in the garden. He can even toss a ball. Unexpectedly, he can also feel: The re-innervated nerves in his pectoral muscles can receive signals, so he can sense whether an object he has picked up in his mechanical hand is hard or soft, hot or cold.

Kuiken imagines that one day people might become bionic beings like TV's Colonel Steve Austin. But he says that's probably decades away. "The reality is that this," he says, extending his right arm, "is the most incredible machine in the world. We cannot match this." What he's likely to do, though, is improve the lives of civilians and soldiers who lose their arms and legs by the thousands every year. ■

—By Michael Arndt



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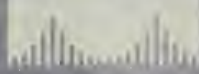
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The Daily Paper of Tomorrow

The boss walks into your office and shuts the door. Sits down. Looks you solemnly in the eye. “We’re buying a bunch of newspapers from Knight Ridder,” he says. Tilts back in his chair. “We know there’s something to be done with them, but we don’t know what. Your new job is to figure that out. Which functions can go, which stay, what must be expanded, where

the new revenue is. We—well, you—will remake the local newspaper for this century.” He holds your gaze, nods twice, and exits.

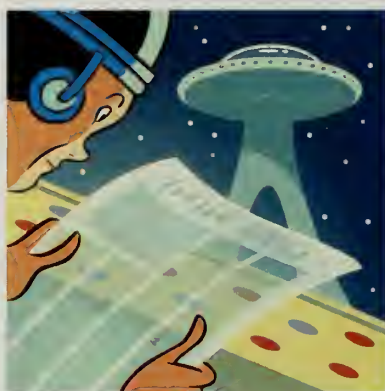
At which point, judging from the reactions of those to whom this scenario was suggested, you put your head down and weep. Even among other still-profitable-yet-challenged media, newspapers have an especially bad case of cooties. “The components of what we historically know as the newspaper have become unbundled,” says Warburg Pincus managing director Mark Colodny. Google and Yahoo! can offer sharply targeted local ads, craigslist has free classifieds, news is free everywhere, and next-generation news aggregators such as topix.net and inform.com are creeping in.

What’s to be done? One recent blogger notion involves seeking federal assistance, but PBS can tell you how well that works. Absent extracting newspapers from investors’ profit demands, your to-do list likely includes the following:

STEAL FROM GOOGLE. Make your ads hyper-accountable. Identify the top advertisers in your local market and figure out what it would take to grab 100% of their ad budgets. Give them unlimited pages, on paper and online, until they reach their goals. You’re the biggest guy in town. Your per-page cost of newsprint is cheap—and your per-impression cost online is even cheaper. Leverage that to cut off your rivals’ oxygen.

BIFURCATE. Take what the *The Washington Post* and *Chicago Tribune* are doing a step further: Offer a free news-digest daily aimed at your least committed readers. Then price up a more elite daily newspaper, so the old \$1 ceiling becomes the new floor for single-copy prices. Goodbye, daily paper. Hello daily papers—one mass (free) and one premium. And given the elite daily’s audience, charge more for its ads.

REDEPLOY MERCILESSLY. Save pages and dollars: Put all stock and TV listings online. Rethink everything and ask hard questions: Do you need a Washington bureau if you’re not *The Washington Post* or *The New York Times*? How much



international news do your readers want—can you pick it up from other sources, or read it online? Do you need a Saturday edition? Send a blogger, not a phalanx of reporters, to the news-free Republican and Democratic conventions. Which critics and columnists are crucial, and which won’t be missed? Can you outsource the phone sales of your classifieds?

INCREASE LOCAL COVERAGE. An old saw, but local is newspapers’ last unique attribute. It also provides the lens through which you view the larger world. What foreign reportage matters most to your readers? Find out which countries receive the most money from local residents.

REDESIGN YOUR PREMIUM PRODUCT. Production values for other media are higher than they’ve ever been. Do your pages have to look so newspaperish? A classier environment attracts richer advertisers.

It won’t look the same. But with reimagining, the local daily ain’t dead yet

USE YOUR READERS. Building communities and businesses around community-created content was not invented by MySpace.com. One bright spot for the Reader’s Digest Assn. is Reiman Publications, which runs a host of homey, ad-free titles that lean heavily on reader-written contributions. Is there a sufficient subcultural pulse in your city to pull off a mini-myspace? Are locals writing hobbyist blogs that you can build about.coms around? There have always been more talented content creators than full-time jobs for them; the platform of the Net makes them visible. Do you want them inside your tent as partners or outside it as competitors? ■

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JAMES C. COOPER

Can the Fed Keep Things Cooking at a Low Boil?

s new goal: Ensuring that the economy doesn't overheat

U.S. ECONOMY During the past year and a half of rate hikes, Fed-watching sometimes has been downright boring. That's mainly because the Federal Reserve stated its basic goal and the strategy to achieve it more clearly than at any time in the past. In a nutshell, the economy no longer needed unusually low interest rates to guard

against Japanese-style deflation. So the Fed set out to lift rates gradually back to a neutral level that would neither stimulate nor restrict economic growth, while keeping inflation under control.

Well, guess what? That job is done. The Fed said as much in its statement accompanying its Dec. 13 rate hike. For 2006, however, Fed policy promises to be a lot more complicated. And that will be true even though Ben S. Bernanke, who takes the Fed chairmanship from Alan Greenspan on Jan. 31, is a strong proponent of greater openness in policy communication. It's because the Fed has a brand new goal, and its strategy will not be as predictable as it has been up to now.

The new focus first showed up in some Fed-speak contained in that same Dec. 13 statement. Policymakers turned that "possible increases in resource utilization" into a warning about price pressures. In plain English, that means the Fed thinks the economy is near the point where the labor markets and production facilities will begin to strain to keep up with demand. That could cause the economy to overheat, putting excessive steam behind wages and prices.

This task is far trickier to carry out and communicate than simply shifting policy back to neutral. The Fed now has to decide how much to limit economic growth without stopping it cold. That's an especially delicate job, given the interest rate sensitivity of housing. The biggest risk of overtightening in the coming year is that higher rates could cause housing activity and home prices, which have been key to overall growth, to collapse, perhaps dragging down consumers and the economy.

HOW WILL THE FED carry out this new and more cautious policy phase? Right now, the markets are betting that the central bank will lift its target federal funds rate to either 4.5% or 4.75%, up from 4.25% currently, and then pause to see what raising the rate from 1% in June, 2004, has wrought. The real funds rate, which is adjusted for inflation, is close to its long-run average, one sign that policy is close to neutral (chart). But given the Fed's new watchwords, two trends will have to be clear before policymakers can feel comfortable about putting rate hikes on hold. One, the economy will

have to show that it is slowing down from its surprisingly robust pace of 2005. And two, measures of core inflation, which exclude energy and food, will have to remain tame, indicating that the 2005 surge in energy prices is not working its way into inflation more broadly.

On the latter trend, policy officials are breathing easy. The latest news on the Fed's preferred measure of

inflation, the core price index for personal consumption expenditures, shows a scant 0.1% rise in November, the same as in October. Those increases were less than the 0.2% gains in both August and September, and the yearly rate fell to 1.8%, the lowest such reading in more than a year and a half. That pace is well

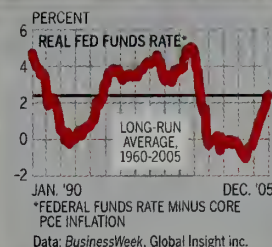
within the 1% to 2% comfort zone of several Fed officials.

However, because of the lag between the time the Fed makes a rate change and the time it affects the economy, the Fed doesn't make policy based on last month's price indexes. And that is why policymakers are now focusing on resource utilization. On that front, Fed officials are feeling a bit nervous because the economy is showing almost no signs of slowing down.

THE FOURTH QUARTER, measured by real gross domestic product, will be weakened a bit by the impact of the hurricanes and the dropoff in car sales from a summer peak that was exaggerated by special deals. However, the latest readings on consumer spending and industrial production suggest the economy was gaining momentum as 2005 drew to a close, portending a speedup in first-quarter GDP growth.

In November, for example, inflation-adjusted consumer outlays posted the strongest gain since July, and holiday sales appear to have been pretty good. Also, post-Katrina rebuilding and an oil patch recovery pushed up industrial output to the fastest two-month rate in

BY ONE MEASURE, POLICY IS NOW NEUTRAL



seven years, following September's plunge. Output of high-tech equipment is booming, but even excluding tech production, factories are using nearly 80% of their production capacity, the highest rate in 5½ years (chart).

Despite rising pressure on industrial capacity, though, the Fed's new attention to resource utilization will be focused on the labor markets. The unemployment rate is a low 5%, and strong economic growth would only tighten the job markets further. Already, pay of production workers is rising at a 3.2% clip from a year ago, the fastest yearly pace in more than 2½ years.

One forward-looking indicator suggests further acceleration. The Bureau of National Affairs' Wage Trend Indicator, a composite of gauges that foreshadow wage patterns, rose in the fourth quarter to the highest level in more than four years. The BNA says the factors that normally precede wage increases now suggest a moderate acceleration in wage growth.

OF COURSE, THE FED isn't going to raise rates just because wages are growing faster. Moreover, as the late 1990s proved, there is no magic number for the jobless rate that will spur inflationary pressures. What the Fed will be watching for are signs that the growth in wages is greatly exceeding the ability of productivity gains to offset them. That's the point at which tight labor markets will start to place upward pressure on inflation.

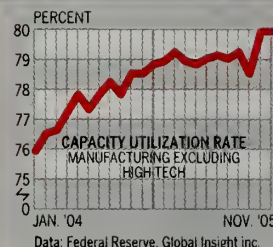
On that front, keep an eye on unit labor costs, reported each quarter by the Bureau of Labor Statistics. These are wage costs, which account for about 70% of overall

production costs in the economy, that are adjusted for productivity, and they are closely correlated with pricing trends. For 2005, unit labor costs appear to have grown less than 2%, a pace generally accepted to be consistent with tame inflation. The Fed would most likely welcome a continuation of that pattern in 2006, but any sizable

speedup from that pace would set off alarms.

The Fed will also pay close attention to what's happening in the housing market. After all, housing is the economy's most interest-sensitive sector, and the first indication that past rate hikes are gaining traction will show up there. But the Fed's influence—or lack of it—on long-term rates

FACTORY OPERATING RATES ARE ON THE RISE



in the bond market makes housing the Fed's most delicate balancing act. Long-term bond yields are still below where they were when the Fed started to lift short-term rates (box).

One of the key questions for 2006: Is the current low level of bond yields, which influence mortgage rates, consistent with the Fed's goal of assuring that the economy doesn't overheat? If not, then bond yields will have to go higher at a time when housing activity and prices would be increasingly vulnerable. ■

THE BOND MARKET

Don't Watch This Curve Too Closely

WHO'S AFRAID OF an inverted yield curve? Not everybody, including many Wall Street economists and even Federal Reserve Chairman Alan Greenspan.

The yield curve is a graph of interest rate levels across all the various maturities, from the overnight federal funds rate to the 10-year Treasury note (chart). Normally this curve slopes upward, showing long-term rates that are greater than short-term rates. An inverted yield curve occurs when short rates become higher than long rates.

Why is that ominous? Because the current 4.25% federal funds is right now a hair's breadth away from the 4.37% yield on 10-year Treasuries,

with further Fed rate hikes likely, and an inverted yield curve has preceded the last five recessions. Historically, this upside-down rate pattern has meant that the bond market expects the Fed at some point in the not-too-distant future to start cutting interest rates to shore up a weakening economy. That would be one explanation of why bond yields are so low right now, despite the Fed's 13 quarter-point rate hikes in the past year and a half.

However, many economists believe that the yield curve no longer sends the same message. Edward Yardeni at Oak Associates, for one, says financial deregulation, which in 1986 abolished interest rate ceilings

that savings banks could pay on deposits, is the biggest difference. Before deregulation, as the Fed jacked up short-term rates, money for mortgages and other loans would dry up as investors sought higher yields outside the banking system. Credit crunches and recessions followed.

Now, however, the message in the yield curve may have changed. "In my opinion, the shape of the yield curve provides more insight into the [bond] market's outlook for inflation than for real economic activity," says Yardeni. Indeed, Greenspan has gone so far as to say that the yield curve is no longer a useful guide to the economy.

Of course, many in the bond market still disagree. But keep in mind that while the yield curve has inverted prior to the past five recessions, it also turned upside down in 1995 and 1998, signaling absolutely nothing. ■

AS THE YIELD CURVE TURNS



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News you need to know

EDITED BY HARRY MAURER

Solid Holiday Sales It looks as if the economy can rejoice, or at least relax: Santa did show up this year, albeit a bit late. Shoppers started the crucial holiday season with a decent **Black Friday** weekend, then went AWOL for much of December, only hitting the malls in force as Christmas loomed. Final numbers won't be available until mid-January and early estimates vary, with **MasterCard's Spending-Pulse** service predicting an 8.7% boost over 2004 but other analysts pegging it as low as 3%. **ComScore Networks** figures e-tail sales will jump 24%.



It all adds up to respectable, not spectacular, gains.

One reason Americans played the waiting game is that they held out for last-minute markdowns. They're also spending bigger bucks on gift cards, whose sales aren't recorded until they're redeemed. That makes for an added burden on retailers, which have to craft a spiffy new strategy for Phase Two: the last week of the year.

Weird Interest Rates When rates on two-year Treasuries rose above those of 10-year notes on Dec. 27, the dreaded "inverted yield curve" scared the Street, driving the Dow down 105 points. That's because the anomaly of short-term rates going higher than longer-term ones has preceded the last five recessions. But many economists, including a noted one named **Alan Greenspan**, think spooky yield curves may not mean what they used to.

See "Don't watch this curve too closely," page 22, and "A better spread to watch," www.businessweek.com/go/tbw

Guidant's Ailments It's a curiosity of the battle over Guidant: The more damaged the medical device maker appears, the better it is for suitor **Johnson & Johnson**. On Dec. 23, a Guidant filing revealed that fourth-quarter earnings would be sicklier than Wall Street expected. Four days lat-

er, Guidant disclosed it had gotten a warning letter from the **FDA** about problems at one of its plants. The news sent shares down 3.4%, to around \$65, close to J&J's offer of \$63. The market evidently suspects that Boston Scientific, which has bid \$72 per share, won't swing a deal. Shareholders will vote on the J&J offer on Jan. 31.

NBC Beams Up MSNBC This could be the end of MSNBC as we know it. A decade after **Microsoft** and NBC co-created the cable news service, **General Electric's** NBC Universal unit announced on Dec. 23 that it's buying majority control from its partner. MSNBC runs third in the cable news race, behind **Fox News** and **CNN**, and is neck and neck with **CNN Headline News**. NBC executives say that **GE** CEO **Jeff Immelt** has often compared MSNBC unfavorably to Fox's hard-edged cable channel and will press it to forge more of an identity. The deal marks Microsoft's second exit from the news business in a year. It sold e-zine **Slate** to **Washington Post Co.** in late 2004.

No Free Lunch for Wal-Mart An Oakland (Calif.) jury found that Wal-Mart has been naughty, not nice, handing the world's biggest retailer another lump of PR coal at the height of the Christmas season. The jury on Dec. 22 ordered Wal-Mart to pay \$172 million to thousands of California workers who claim they were denied lunch breaks in violation of a 2001 state law. A spokeswoman says Wal-Mart, which has class actions pending against it in some 40 states, plans to appeal.

A Grocery Deal Goes Sour Albertson's probably wasn't in a mood to enjoy its holiday dinner, either. On Dec. 22 the Boise (Idaho) supermarket and drug giant said it had ended talks on a complicated deal that might have given different parts of the company to private investment house **Cerberus Capital Management**, real estate investment trust **Kimco Realty**, and retailers **Supervalu** and **CVS**. Albertson's says it's still talking with "several parties" interested in acquiring "underperforming assets." Investors knocked the stock down 9% by Dec. 28.

Alaska Drilling Hits a Rock The caribou don't have to look for greener pastures just yet. **President George W. Bush's** five-year effort to tap black gold in the **Arctic National Wildlife Refuge** went down to defeat once again on Dec. 21, as moderate Senate Republicans joined Democrats to yank the measure from a bill to fund the Pentagon and hurricane relief. **Senator Ted Stevens** (R-Alaska), resplendent in an Incredible Hulk power tie, vowed a new effort in 2006—and revenge upon senators who blocked the quest he has pursued since 1980. But with Bush's political capital much depleted and tough midterm elections looming, the GOP may think twice about taking on the enviros.

Microsoft's Worries in Europe The European Union shook a big stick at Microsoft on Dec. 22, threatening \$2.5 million a day in fines for failing to comply with sanction

posed in a 2004 decision that the software kingpin violated competition law. That ruling called for Microsoft to release technical data, but a monitor calls its released documentation "fundamentally flawed." **Microsoft General Counsel Brad Smith** says that the company wants to meet the EU's demands and that "every time we make a change, we find that the commission moves the goalpost." Microsoft has until Jan. 25 to reply and show compliance.

Nacchio's Nadir Latest high-profile manager to undergo the perp walk: **Joe Nacchio**. The former **Qwest** CEO, who maintains his innocence, was indicted by a federal grand jury on 42 counts of allegedly unloading stock in 2001 when he knew of his company's parlous finances. He appeared in a Denver court in handcuffs and was freed on \$2 million bond. The indictment had been expected since March, when the SEC sued him and six other former Qwest executives. Some Qwesties have already pled guilty to criminal charges, but insider trading is famously tough to prove in court.

See "The case against Qwest's Nacchio," www.businessweek.com/go/tbw

Romancing ACS? It's nice to be popular, and outsourcing and tech service firms seem to be the belles of the ball. **VeriGard** sold last March for \$11.3 billion. **Computer Sciences** nearly went for \$12 billion in November before the deal fell through. The latest to get asked to dance, according to *The New York Times*, is **Affiliated Computer Services**, a Dallas out-sourcer with \$4.3 billion in sales. Who's doing the asking? Private equity firms, continuing their record 2005 leveraged-buyout rampage. The *Times* says **Texas Pacific Group**, **Fin Capital**, and **Blackstone Group** propose to buy ACS for about \$8 billion.

Plea Bargain of the Week

The water was already plenty hot for **Ken Lay** and **Jeff Skilling**, and it just went up about 20 degrees. On Dec. 28, **Richard Causey**, ex-chief accountant of **Enron**, pleaded guilty in federal court in Houston to felony securities fraud. He faces five to seven years in jail and agreed to pay a \$1.25 million fine. Causey presumably will testify at former Chairman Lay and former President Skilling's trial, now scheduled to start on Jan. 30. That has to worry defense lawyers, since Causey and fellow plea bargainer **Andrew Fastow** may be capable of unraveling for a jury the complex shenanigans that allegedly brought Enron low. But the deal could complicate life for the prosecution, too. The explosion of publicity about Causey's plea could fortify the defense's demand for a change of venue on the grounds that jurors in Houston can't judge the case dispassionately.



RICHARD CAUSEY



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TALENT

THE STRUGGLE TO MEASURE PERFORMANCE

Rigid rankings hinder the teamwork and risk-taking necessary for innovation. But what combination of methods works best?

BY JENA MCGREGOR

HOLIDAY SHOPPING, yearend deadlines, and emotional family dramas aren't the only stresses in December. 'Tis the season for companies to embark on that dreaded annual rite, the often bureaucratic and always time-consuming performance review. The process can be brutal: As many as one-third of U.S. corporations evaluate employees based on systems that pit them against their colleagues, and some even lead to the firing of low performers.

Fans say such "forced ranking" systems ensure that managers take a cold look at performance. But the practice increasingly is coming under fire. Following a string of discrimination lawsuits from employees who feel they were ranked and yanked based on age and not merely their performance, fewer companies are adopting the controversial management tool. Critics charge that it unfairly penal-

izes groups made up of stars and hinders collaboration and risk-taking, a growing concern for companies that are trying to innovate their way to growth. And a new study calls into question the long-term value of forced rankings. "It creates a zero-sum game, and so it tends to discourage cooperation," says Steve Kerr, a managing director at Goldman Sachs Group Inc., who heads the firm's leadership training program.

MORE FLEXIBILITY

EVEN GENERAL ELECTRIC CO., the most famous proponent of the practice, is trying to inject more flexibility into its system. Former Chief Executive Jack Welch required managers to divide talent into three groups—a top 20%, a middle 70%, and a bottom 10%, many of whom were shown the door. Eighteen months ago, GE launched a proactive campaign to remind managers to use more common sense in assigning rankings. "People in

some locations take [distributions] so literally that judgment comes out of the practice," says Susan P. Peters, GE's vice president for executive development.

Striking that balance between strict yardsticks and managerial judgment is something every company, from GE to Yahoo! to American Airlines, is grappling with today. But finding a substitute for rigid grading system is not an easy task. It drives truth into a process frequently eroded by grade inflation and helps leaders identify managers who are good at finding top talent.

That's one reason GE isn't abandoning its system. But it has removed all references to the 20/70/10 split from its online performance management tool and now presents the curve as a set of guidelines. The company's 200,000 professional employees tend to fall into Welch's categories anyway, but individual groups are freer to have a somewhat higher number of "A" players or even, says Peters, n-

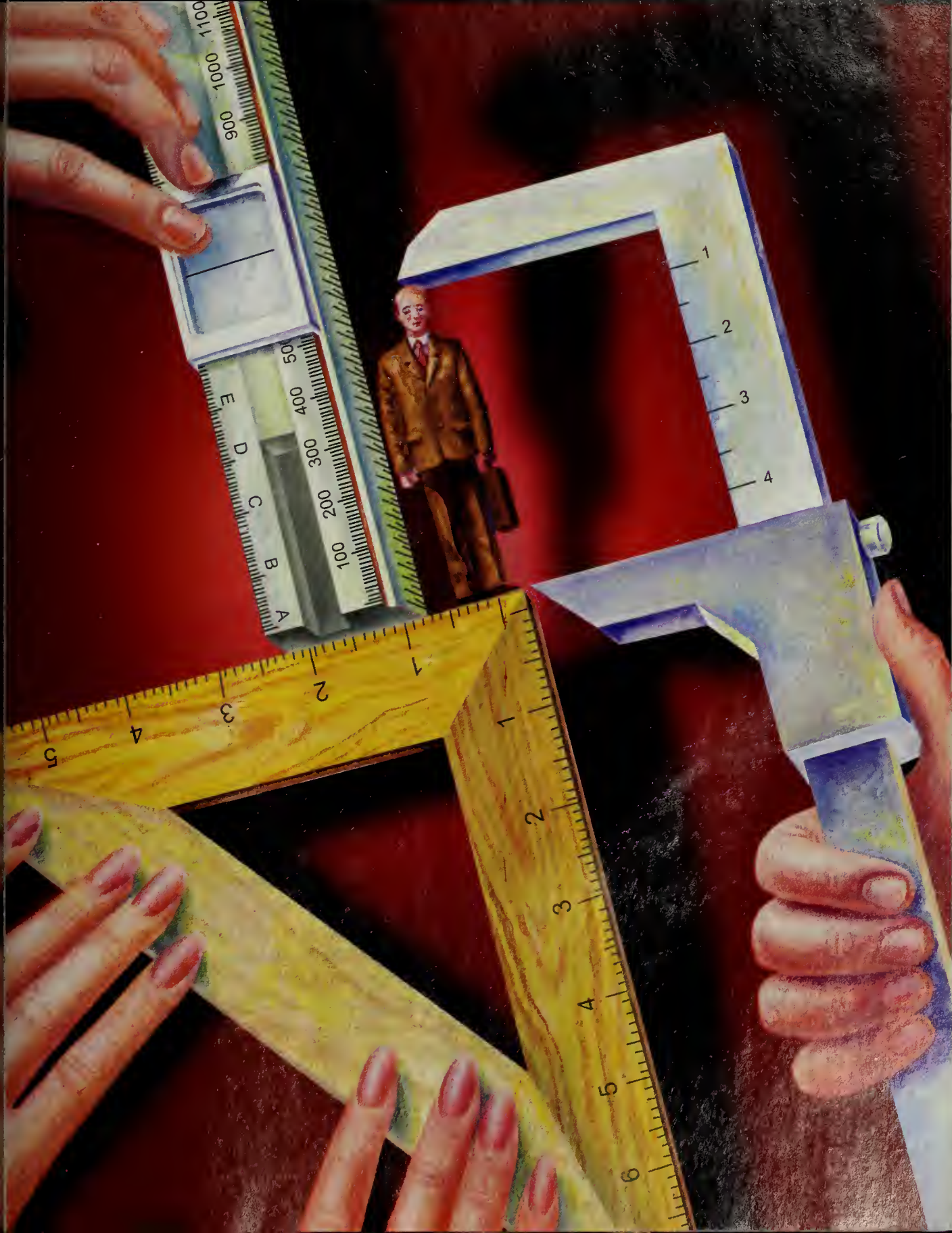
SO IN THIS SECTION:

9 | Why Webzines want
to be on paper, too

30 | Sony wants you to curl
up with an e-book

34 | Time for the Dow
to ditch GM?

36 | Friendly advice for
Exxon's new CEO



"bottom 10s." Even those low achievers are getting some kinder treatment, from a new appellation—the "less effectives"—to more specific coaching and intervention than in the past.

The changes are key for a company trying to evolve its culture from a Six Sigma powerhouse to one that also values innovation. Tempering such rigid performance metrics, says Peters, "enables individuals and organizations to be more comfortable with risk-taking and with failure." To drive that point home, the company's top 5,000 managers were evaluated for the first time this year on five traits, such as imagination and external focus, that represent the company's strategic goals.

NEW DATA

SEPARATING STARS from slackers remains a long-standing part of GE's performance-driven culture. But for most companies, especially those without such cultures, the benefits of adopting a forced ranking system are likely to dissipate over the long term.

A recent study lends hard data to that theory. Steve Scullen, an associate professor of management at Drake University in Des Moines, found that forced ranking, including the firing of the bottom 5% or 10%, results in an impressive 16% productivity improvement—but only over the first couple of years. After that, Scullen says, the gains drop off, from 6% climbs in the third and fourth years to basically zero by year 10. "It's a terrific idea for companies in trouble, done over one or two years, but to do it as a long-term solution is not going to work," says Dave Ulrich, a business professor at the University of Michigan at Ann Arbor. "Over time it gets people focused on competing with each other rather than collaborating."

One company that recently decided to dump forced rankings altogether is Chemtura, a \$3 billion specialty chemi-

cals company formed by the July merger of Crompton in Middlebury, Conn., and Great Lakes Chemical in Indianapolis. "The system forced me to turn people who were excellent performers into people who were getting mediocre ratings," says Eric Wisniewski, Chemtura's vice-president for corporate finance. "That demotivates them, and they'd follow up

tain, Yahoo's senior vice-president for human resources, knew that review discussions at the Sunnyvale (Calif.) tech leader frequently included the wink-wink "wanted to put you here, but I was forced by human resources to do something different" comment that discredits so many appraisals. This year, Yahoo stripped away its performance labels, partly in

hopes that review would center more on substance and less on explaining away a grade.

But that doesn't mean Yahoo went all Pollyanna on its employees. To do a better job of finding and showering top performers with the rewards necessary to keep them from jumping ship in talent tight Silicon Valley, the company also instituted a "stack-ranking" system this year to determine how compensation increases are distributed. It asks managers to rank employees within each unit—a group of 20 people would be ranked through 20, for example—with raises and bonuses distributed accordingly. During reviews, employees are told how their increase generally compares to those of others.

Some Yahoo managers are livid about the new system. "It's going to kill morale," laments one senior engineering manager who says he's getting a stronger message to cull his bottom performers. Yahoo says its new program doesn't

automatically weed out a bottom group and was designed specifically to reward its stars.

Indeed, what Yahoo has introduced in place of its old system shows how hard it is for companies to find ways to foster merit-driven cultures that coddle standouts while staying tough on low performers. Whether a company calls it stack ranking, forced ranking, or differentiation, "there's no magic process," says Saitain. "We just want to make sure we're making our bets and that we're investing in the people we most want to keep. That's what this is all about." ■

PLAYBOOK: BEST-PRACTICE IDEAS

Performance Art

Review season is here, with all the time-consuming bureaucracy and stress that comes with it. Here are five ideas to help put performance back into the process:

MEET MORE OFTEN Time-strapped managers may sound a collective groan, but yearend reviews on their own are hardly enough. The best managers meet at least three times a year, if not four—once to set goals, once or twice for an update, and finally, to review—with many informal check-ins in between. In this quickly shifting economy, goals may change, and fewer surprises will surface at yearend.

MAKE ROOM FOR RISK As innovation trumps efficiency, some companies—including GE—are putting some wiggle room into their rankings and ratings. But more flexible guidelines have to have teeth, too: Low-performing units shouldn't get more than their share of top grades, for example. Exceptions should go to people who set aggressive goals and come close to achieving them.

ADJUST GOALS ALONG WITH GRADES While many companies use "calibration" sessions to check that performance assessments level out among different managers, less than 10% fine-tune upfront goals across groups, according to Hewitt Associates.

CHOOSE WORDS WISELY Whether or not you strip the labels off your performance reviews entirely, as Yahoo has, faint-praise terms such as "fully satisfies" make essential B-players feel like also-rans. Try "strong" or "successful" to drive home their value.

BUILD TRUST With so much focus on the tools and tricks of performance management, it's easy to lose sight of what really matters: the conversation. The University of Michigan's Dave Ulrich suggests putting three simple words—"help me understand"—in front of difficult feedback.

with asking: "What could I do differently next year?" That's a very difficult question to answer when you feel that people actually met all your expectations." Chemtura's new process still assigns grades. But to better motivate employees in the middle, labels such as "satisfactory" have been upgraded to phrases such as "successful performance."

Yahoo, too, was looking for better dialogue and less demoralizing labels when it made substantial changes this year to its rating system, which compared employees' performance to an absolute standard rather than to each other. Libby Sar-

PUBLISHING

CALL IT GUTENBERG'S REVENGE

Webzines are launching print versions to boost their readership and advertising

LOUISE LEE

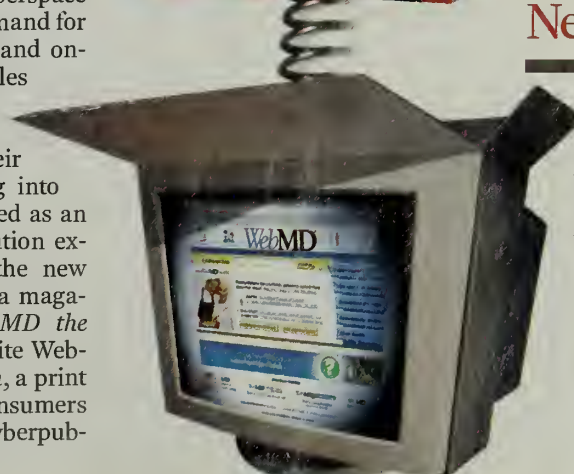
WHEN BABYCENTER.com was born in 1997, the parenting e-zine reveled in the cost savings to be found in cyberspace. No postage or paper bills to worry about. Ink? So yesterday. So it comes as quite a surprise that eight years later, at a time when the magazine industry is falling over itself to boost its presence online, that BabyCenter has launched a version of its popular Web

magazine on—gasp—paper. As wired as the world is today, there is still a place for the old-fashioned magazine. BabyCenter researchers visiting parents' houses last year saw shelves full of books on parenting. "Then we'd notice a stack of parenting magazines in the living room," says BabyCenter President Ari J. Baker. In September the e-zine launched a paper magazine with stories on eating habits during pregnancy and chic maternity clothes. Sticking exclusively to online, says Baker, would leave many ad dollars on the table.

Traditional magazines from *Time* to *Playboy* years ago started cyberspace versions to keep up with the demand for around-the-clock news updates and online communities. Now the tables have turned. Upstart Internet publishers, helped by low costs that go with signing up their online members, are venturing into the print world they once viewed as an outpost of paper and distribution expenses. Besides BabyCenter, the new web-to-print ventures include a magazine devoted to Google, *WebMD the Magazine*, spun off from Web site WebMDHealth Corp., and *AlwaysOn*, a print version of the tech Web site. Consumers bounce on and off the Web, so cyberpub-

lishers must "surround the readers and be wherever they are," says independent consultant Gerry L. Ginsburg.

Even with online subscribers to leverage, there's no guarantee, of course, that these new entries will stick. Most print magazines don't survive for more than a few years. The few online brands that have tried print editions shuttered them. Ziff-Davis began publishing *Yahoo! Inter-*



net *Life* in 1996 but pulled the plug six years later, after the dot-com bubble burst. *Expedia Travels* met the same fate in 2001. There's more art than science in figuring out which brands can transfer to print. While *Yahoo* offered topics that were perhaps too general—ranging from online shopping to privacy—Sandhills Publishing Co. in Lincoln, Neb., launched quarterly *Google* with articles focused on mining the Web portal for fun and profit.

PULP FRICTION

SUCCESSFULLY MOVING from bytes to pulp requires special articles and photos that neither compete with nor mimic online content. "You have to give the reader a reason to pick up the magazine," says Ginsburg. *WebMD the Magazine* includes checklists of questions readers can tear out and take to doctor appointments. "The magazine is designed for people waiting 20 minutes and to help them prepare," says Wayne T. Gattinella, president and CEO of WebMDHealth, which distributes 1 million copies of the bimonthly free to 400,000 waiting rooms.

Any online-only magazine is missing out on a lot of readers. According to researcher InsightExpress LLC, 68% of consumers don't read any magazines online. Of that group, 54% say they shun them because they're inconvenient, while 47% say they don't like banner ads and pop-ups.

Advertisers, too, still have a soft spot for print. People are more engaged reading magazines than they are online, says

Magazine readers pay more attention to ads than do Net surfers

Andrew Swinand, senior vice-president at Starcom Media-Vest Group, the media strategy arm of ad agency Publicis. When readers put in the effort to digest a magazine, they are also apt to read an ad, says Swinand: "More synapses are firing in the brain."

Even in an age when going paperless is a virtue, Web publishers find the physical presence of paper brings credibility. That's one reason why Tony Perkins, founding editor of the technology site *AlwaysOn*, last March launched a quarterly magazine distributed to a mix of tech companies, professional associations, and individuals paying \$39 a year. Perkins credits the magazine with goosing demand for his \$49-a-year advanced online subscription, which offers premium content. It's attracting about 1,000 takers a month, vs.

Venturing Offline

Online 'zines are turning to Old Economy publishing to capture more attention

ALWAYSON This tech site launched a quarterly magazine to drive awareness of the site. And it has found that people take the site more seriously because it has a "real" magazine.

BABYCENTER The online community of mothers is now getting a printed magazine. It turns out moms like to curl up with the pages between their fingers, and advertisers want to reach them with slicker ads than the Net allows.

WEBMD The health-and-medicine Web site saw an opportunity to exploit doctors' waiting rooms. The magazine is designed to be skimmed in 20 minutes and draws in new visitors not aware of the site beforehand.

100 before he launched in print. The print version is also attracting blue-chip advertisers including Hewlett-Packard, Audi, and palmOne, which shell out \$50 per 1,000 print readers—vs. less than \$20 to reach the same number online.

These Webzines are also simply pursuing logical brand extensions. In BabyCenter's case, the print magazine is cashing in on its popular online name. Acquired by Johnson & Johnson in 2001 (the magazine says it maintains editorial independence and carries competing ads), BabyCenter's traffic of 4 million monthly visitors makes it the top site of its kind, says research firm comScore Networks Inc. But there are only so many places on its site to advertise. Now, BabyCenter is publishing different versions of the magazine aimed at women in various stages of pregnancy and child rearing. The expectant mom gets a magazine with articles on delivery; three months after the birth, she gets a version with ads and articles related to nursing and diaper rash.

Marketers love that kind of targeting. Beech-Nut Nutrition Corp. boosted its spending with the publisher by 20% through the print magazine, putting half-page ads in the edition aimed at mothers of newborns and running full-page ads in later editions when the baby is on solid food. Earl Justice, Beech-Nut's senior product manager, says a magazine is a "more personal interaction with mothers." Clearly, cyberpublishing is where the world is headed—but it looks as if that magazine pile in the living room will be around for a while. ■

GADGETS

CURLING UP WITH A GOOD E-BOOK

The technology hasn't caught the public's fancy, but Sony may be on the right track

BY BURT HELM

CAN SONY CORP. MAKE the iPod of digital books? That's the plan. At the Consumer Electronics Show on Jan. 4 in Las Vegas, *BusinessWeek* has learned, the Japanese giant plans to unveil a portable e-reader device for the U.S. The new gadget will let users store and view digital books and will sell for \$300 to \$500, about the same price range as a full-size iPod. Sony, which would provide few details about the e-reader, also has agreements with at least three major publishers to sell digital book downloads on its Sony Connect online store—much the way Apple Computer Inc. sells music and video at its iTunes Music Store.

Back in 2000, a bunch of e-book readers hit the market, only to tank because the technology didn't adequately duplicate the book reading experience. Now, with everyone from Google to Microsoft to HarperCollins digitizing books, plus the ar-

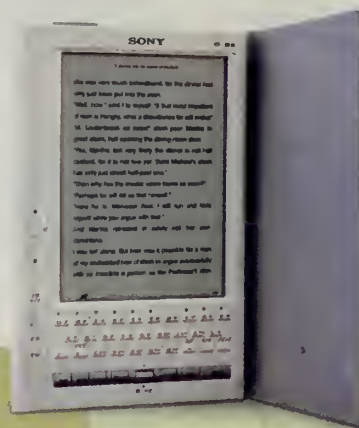
rival of slick new display technology, Sony figures the time is right for a handheld e-reader in the U.S.

But while Sony's iPod-like strategy—seamlessly wedding content to hardware—has promise, reading books on a digital device still feels nothing like the real thing to most consumers. As such, it will be an uphill battle building a sizable market for e-books, which accounted for an estimated 0.2% of the 944 million books U.S. publishers sold worldwide in 2004. "No one has created a device compelling enough to have mass appeal,"

LIBRIE The Japanese version won plaudits, but sales were disappointing

says Nick Bogaty, executive director of the International Digital Publishing Forum, an industry group.

Is Sony up to the challenge? Once the gadget king, the company has suffered a string of recent misses thanks to iffy execution in digital media. Sony's late arrival at the digital music business and its proprietary approach let Apple dominate a category Sony once



The E-book: Chapter Two

Sony's new device features big improvements over previous versions

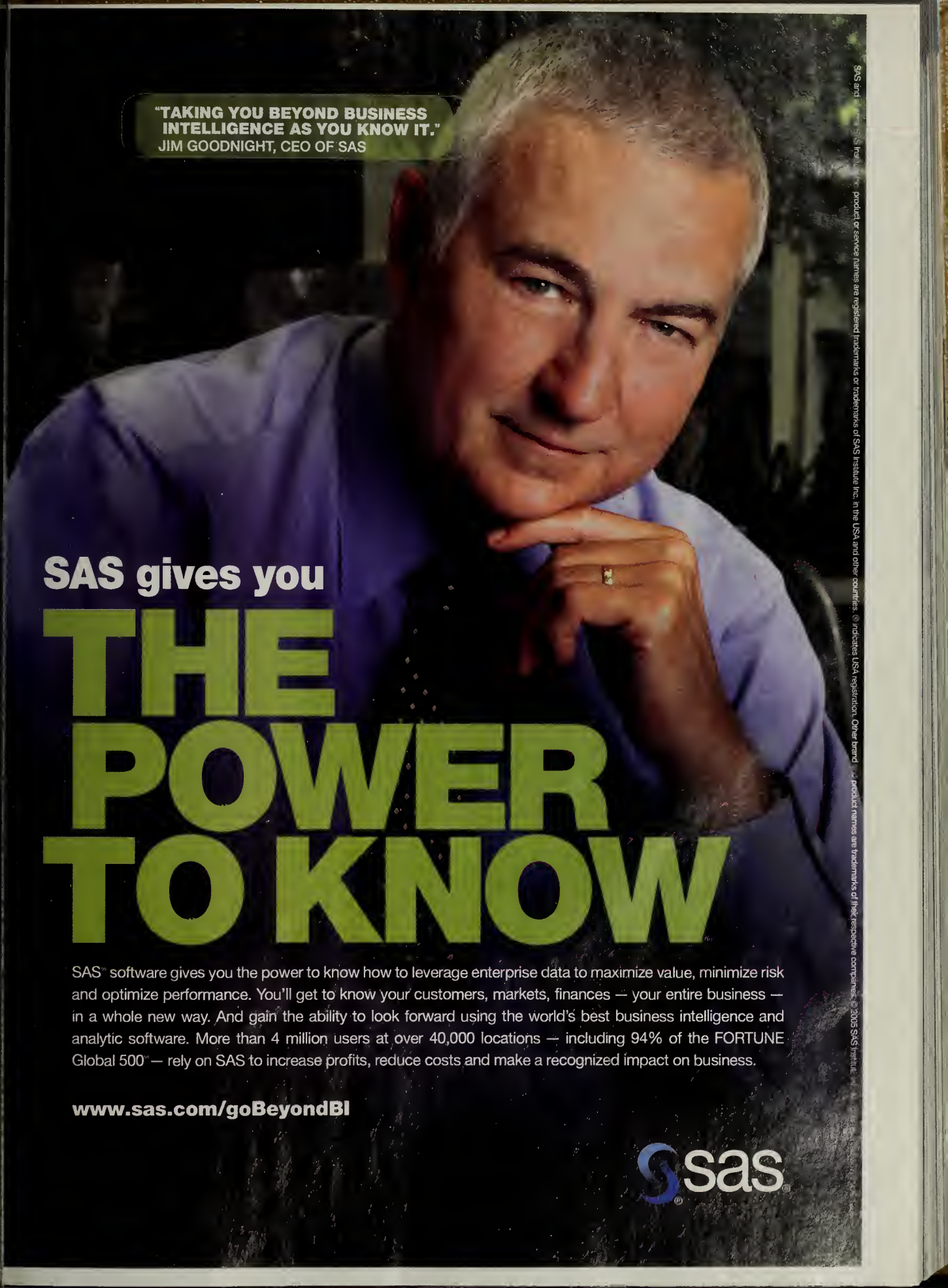
even in direct sunlight—thanks to new technology that approximates a printed page

■ **FUEL-EFFICIENT** Since the device requires no backlight and uses power only to "turn" the digital page, users can read over 15 books between charges

■ **ECHOES OF IPOD** Sony is launching an online store where people will be able to buy and easily download favorite authors to the e-book

■ EASY ON THE EYES

The text is remarkably booklike—and visible



**"TAKING YOU BEYOND BUSINESS
INTELLIGENCE AS YOU KNOW IT."**
JIM GOODNIGHT, CEO OF SAS

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Random House's corporate development group: "[With E Ink you're looking at an advance [in the market] for pure technology reasons...this is a major leap forward in terms of consumer experience."

Appealing technology and the backing of the publishing community are a good beginning. But Sony faces a number of challenges. For one, other companies also have access to the potentially game-changing E Ink technology. Yes, Sony will come to market ahead of the pack. But in the first half of '06, iRe Technologies, a Philips Electronic spin-off, and a Chinese company called Jinke Co. both plan to launch similar devices in the U.S. Then in early '07, another Philips spin-off called Polymer Vision and a British

owned. In 2004, Sony launched an e-book reader in Japan that also failed to take off. Called the Librie, it won plaudits for design, but its high price and draconian antipiracy technology—users could only “rent” books from Sony for 60 days before the books deleted themselves—scared off consumers.

Now, in the U.S., Sony has a second chance to build a market for digital books. While few details about the new reader are available, it's fair to say it will be an impressive piece of gadgetry. According to sources who have seen the device, it is similar in many ways to the Japanese Librie. Both devices use E Ink, a display technology developed by E Ink Corp. in Cambridge, Mass. E Ink forms text by electronically arranging thousands of tiny black and white capsules, creating an experience remarkably similar to reading a printed page. Unlike the liquid-crystal display screens used in personal digital assistants, there is no backlight to strain readers' eyes, and characters show up sharp and clear, even in full sunlight. And since the gadget requires power only to “turn” pages, users should be able to read more than 15 books between charges.

POWERFUL ALLIES

TO CREATE A MARKET for the device, Sony will take a page from Apple by setting up an online store, which will be run as part of its existing music downloading service, Connect. And as Apple did with music, Sony has lined up major players in publishing, including Random House, Simon & Schuster, and HarperCollins, to sell books through the store.

The service will start out with just the



We hope [Sony's new reader will] be the equivalent of when the Walkman or the iPod came out.”

—Jane Friedman,
CEO, HarperCollins Publishers Inc.

few thousand books each publisher currently sells in e-book form at prices close to mass-market paperbacks. But that number will grow fast. Jane Friedman, CEO of HarperCollins Publishers Inc., says she plans to digitize the entire frontlist and backlist—up to 25,000 titles—and make them available at the Sony store as soon as HarperCollins negotiates royalty rights with authors. Random House Inc., meanwhile, will also offer its entire front- and backlist for sale online—another 25,000 titles.

Publishers, looking for ways to boost the industry's anemic single-digit sales growth, are eager to talk up the reader and online store. “We hope it's going to be the equivalent of when the Walkman or the iPod came out” and audio books saw a spike in sales, says Friedman. Adds Richard Sarnoff, president of

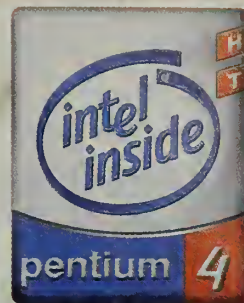
MODERN LIBRARY
Some 50,000 titles should be available in short order



startup called Plastic Logic Ltd. plan to introduce readers that are even more booklike than Sony's device. The Polymer Vision reader will roll up like papyrus while Plastic Logic's reader will be about as flexible as the magazine you're reading.

With rivals in the wings, Sony has a huge incentive to make its reader work with as many formats as possible. That's always a stretch for this famously proprietary company, but Sony seems to be getting religion this time around. Users will be able to load any .pdf file onto the reader, according to a person familiar with the device, as well as files with a special Sony e-book format. That means you'll be able to read everything from magazine articles to analyst reports to out-of-copyright books. And rather than requiring users to transfer data onto the device with Sony's proprietary “memory stick,” the reader also will be able to connect via a computer's USB port and accept standard SD memory cards that are already found in many digital devices.

Beyond that, Sony has to hope consumers find the same pleasure curling up by the fire or on the beach with an e-book reader as they do with an old-fashioned paperback. “[Like online music for years ago], e-books are an untapped market,” says Jupiter Research analyst Michael Gartenberg. “The iPod-iTunes success was an exercise in finding the consumer sweet spot.” Sony badly needs a hit, but repeating Apple's success with books won't be easy. ■



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HP Compaq 17" LCD monitor \$259 (CDW 771188)

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STOCKS

SHOULD THE DOW DITCH GENERAL MOTORS?

GM's troubles are skewing the index and battering investors who bet on it

BY AARON PRESSMAN

WHEN CHARLES H. Dow created the Dow Jones industrial average in 1896, he likened it to a stick jammed into the sand at the beach—a steady reference point for observers to measure the ebb and flow of the U.S. stock market.

Judging from the index' recent performance, the wooden stick might need some repositioning. General Motors Corp., one of only 30 "blue-chip" stocks that make up the Dow, plunged in 2005 to a 23-year low—costing the index nearly 200 points. As a result, through Dec. 23, the Dow lagged behind the other widely followed market gauge, the broader Standard & Poor's 500-stock index, significantly: The S&P 500 was up 6.5%, while the Dow was up less than 1%. (Standard & Poor's, like *BusinessWeek*, is a unit of The McGraw-Hill Companies.)

The poor performance wouldn't matter if the Dow were merely a statistic cited in newspapers. But beginning in 1998, investors have been able to "buy" the index via the Diamonds Trust, an exchange-traded fund (ETF) that tracks it. Almost \$7.5 billion sits in the Diamonds Trust. Since spring, when GM began to slump, investors who bought the ETF based on the S&P 500 have handily beaten those who bought the Dow.

Almost no one would describe General Motors as a blue-chip stock these days. So why, ask some Wall Street vet-

erans, is GM still in the Dow? "They long ago ceased being a barometer of the U.S. economy," says Jeffrey N. Kleintop, chief investment strategist at PNC Advisors in Philadelphia. Only General Electric Co. has a longer tenure in the index than GM, which joined in 1915. Long gone are ghosts of industries past like U.S. Steel and National Lead.

GM is still a huge company, with annual sales of almost \$200 billion. But the company's share of the global auto market has fallen from a peak of 51% in 1962 to 26% today, and Toyota Motor Corp. could surpass it in 2006 to become No.1 worldwide.

BEATEN-DOWN A
General Motors
stock certificate
from 1965



Hitting the Skids

GM has prevented the Dow from reaching the psychologically important 11,000 barrier

11,052.73

» Closing value of the Dow Jones industrial average on Dec. 23, 2005, if GM shares had not fallen by half in 2005

10,883.27

» Actual closing value of the Dow Jones industrial average on Dec. 23, 2005

Data: Dow Jones & Co.

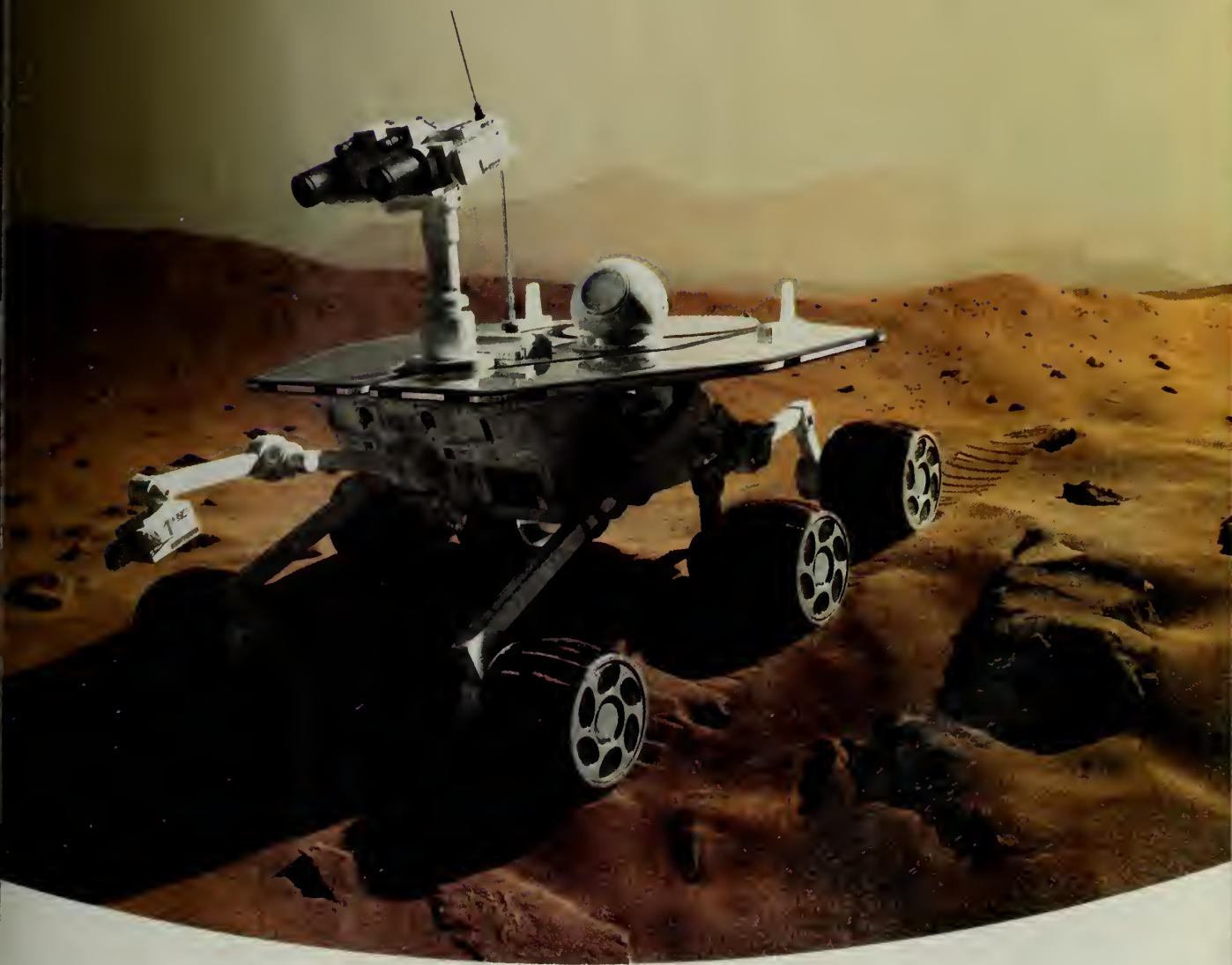
Worse, GM has massive pension obligations, and it gushed \$3.8 billion of red ink in the first three quarters of 2005. Credit-rating agencies are bandying about the "B" word: bankruptcy. "This isn't a farfetched possibility if the kind of deterioration in results we've seen over the past few quarters should continue," said S&P analyst Scott Sprinzen during a Dec. 12 conference call with reporters and analysts. S&P on that day cut GM's corporate credit rating to B, five steps below investment grade. (GM declined to comment on its status as a member of the Dow.)

Some of GM's major shareholders are dumping the stock. Capital Research & Management Co., which runs American Funds, sold 15.5 million shares in the third quarter. More recently, Kirk Kerkorian's Tracinda Corp. which took a big stake earlier in the year, disclosed on Dec. 20 that it had sold 1 million shares.

General Motors has been a drag on many stock market indexes this year, but its effect on the Dow has been especially pronounced. The Wilshire 5000 and the S&P 500 weigh stocks by their market value. But the Dow has always weighed each company according to its share price. That makes GM, at just below \$19 a share, almost as important as Microsoft Corp., which trades around \$22 a share but has a market value 25 times greater. If GM shares were to fall to zero, S&P 500 investors would lose less than one-tenth of 1%. Dow investors would lose more than 15 times that. The Dow "is so strange as an index that it's just scary as an investment," says Tular University finance professor Peter Ricchiuti.

Few expect Dow Jones & Co. to make a change unless GM takes a turn for the worse. The index is chosen by the editors of *The Wall Street Journal*—who, over the years, have been cautious about altering the index. Famously, Dow Jones added Microsoft, Intel, and SBC Communications in November, 1999, the height of the technology bubble. John Prestbo, executive director of Dow Jones Indexes, says he's watching the situation now. "I look in the paper every day for news about GM," he says. Lately, there has been plenty to read. ■

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ZURICH

MEMO TO: REX TILLERSON

SUBJECT: YOUR TO-DO LIST AT EXXON

It's not exactly business as usual at Exxon Mobil Corp.'s sprawling headquarters in Irving, Tex. Lots of folks are out for the holidays. But whether at the office or off in Colorado skiing, the managers of the free world's largest oil company are thinking about returning to work for a new CEO for the first time in 12 years. The legendary Lee F. Raymond is retiring. As Rex Tillerson prepares to take command, National Correspondent Mark Morrison conjures up a welcome-to-the-corner-office memo from Tillerson's staff:

REX: WE KNOW YOU'RE not actually CEO until Jan. 1, but we thought you might appreciate a heads-up on a few things that are likely to turn up on your desk.

With you and Lee out for the holidays, it has been pretty quiet. But those darn politicians up in Alaska are making a big stink again. This is about Valdez—but not the old lawsuit where they're trying to hold us up for billions more over the spill. No, this is about that pork-barrel project they're pushing that would construct a huge liquefied natural gas complex at Valdez to get the gas out of the North Slope. As you know, we want to build a pipeline through Canada to the Lower 48. That's far cheaper than the port idea, not to mention the fact that shipping the gas directly by pipe makes way more economic sense than converting it to liquid and loading it on ships.

The pols haven't a clue how much extra an LNG port would cost—and they don't care. They're licking their chops about how much loot the scheme would generate for the Valdez economy—and their political coffers. Plus, they're playing hardball: They actually sued us and BP this week claiming

we're conspiring to keep natural gas from U.S. markets.

Lee wants to tell the Alaskans where they can stick their LNG idea. But seriously, a better bet is to go head to head on the lawsuit—the case is bogus—and get our lobbyists working overtime to convince saner heads that the Valdez port crowd could kill the North Slope altogether. And you should get involved directly: Have a sit-down with Governor Frank H. Murkowski, where you can put your down-home Texas charm to good effect.

Hard to say if that'll work with those pesky Venezuelans, though. They're giving us a hard time on our oilfield down there and basically want to force us into a joint venture with the state oil company. Our contract is ironclad. And if we let Hugo Chávez get away with nullifying it, every bad guy around the world will be trying the same trick, and our contracts will mean nothing. Lee was livid about this, but we're going to have to find some way to salvage a relationship with the government down there.

Oh, Investor Relations just ducked in to express concern about the '05 earnings announcement. It's gonna be gangbusters. But analysts will want to know what we're going to do with all that money. Cash flow is running about 40% ahead this year, so we can continue buying back shares (through Q3 we've already done about \$12 billion in buybacks) and boost the dividend again. But everybody's wondering whether we're going to spend more on exploration and development. Our cap-ex is only 25% to 30% of cash flow—compared with 70% at ConocoPhillips, where they seem to think inflated oil prices will be around forever. We can tell the analysts that through boom and bust we've been

consistently disciplined about spending to boost production and reserves—and it's worked out pretty well. But will they listen?

The good news is that Lee has left you with virtually no debt and maybe \$30 billion in cash and super earnings. The bad news is that this is one hard act to follow when you consider that Lee took our market cap from \$76 billion in 1992 all the way up to more than \$400 billion now. And the strange thing is, he was the king of cost-cutting who also managed to pull off the deal of all time by buying Mobil. Not only did he double oil reserves and triple revenues, he did it with 9,000 fewer employees

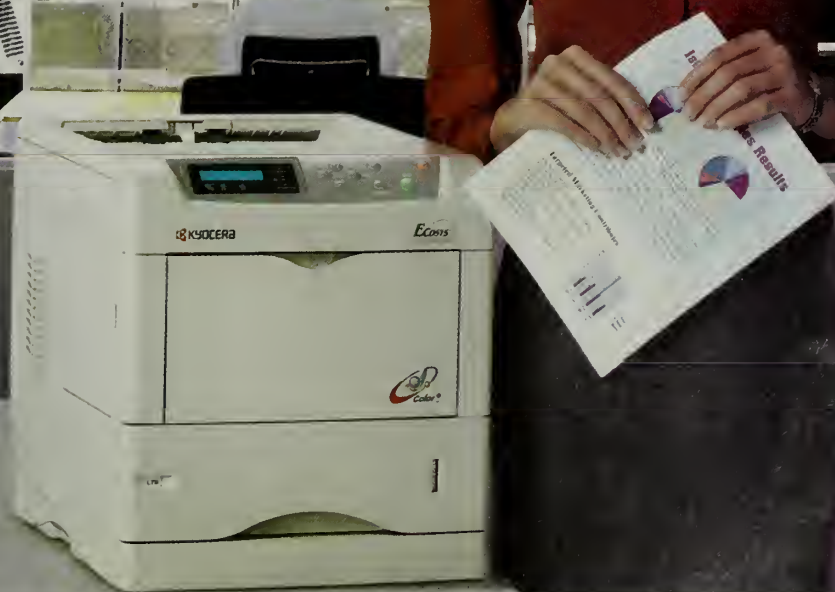


than we had 12 years ago. Nice trick.

You'll be a legend, too, Rex, if you play your cards right. For 30 years you've handled the tough jobs for this company all over the world—Yemen, Russia, Florham Park, N.J.—and beat out all those other smart, aggressive guys to become *numero uno*. And good move signing up Lee for a year of consulting. World leaders treat him as a fellow head of state, and you'll be getting that treatment, too. Plus, you're only 53 and could have just as long a run as Lee.

We wish you a healthy, prosperous '06. And we're behind you 150%. ■

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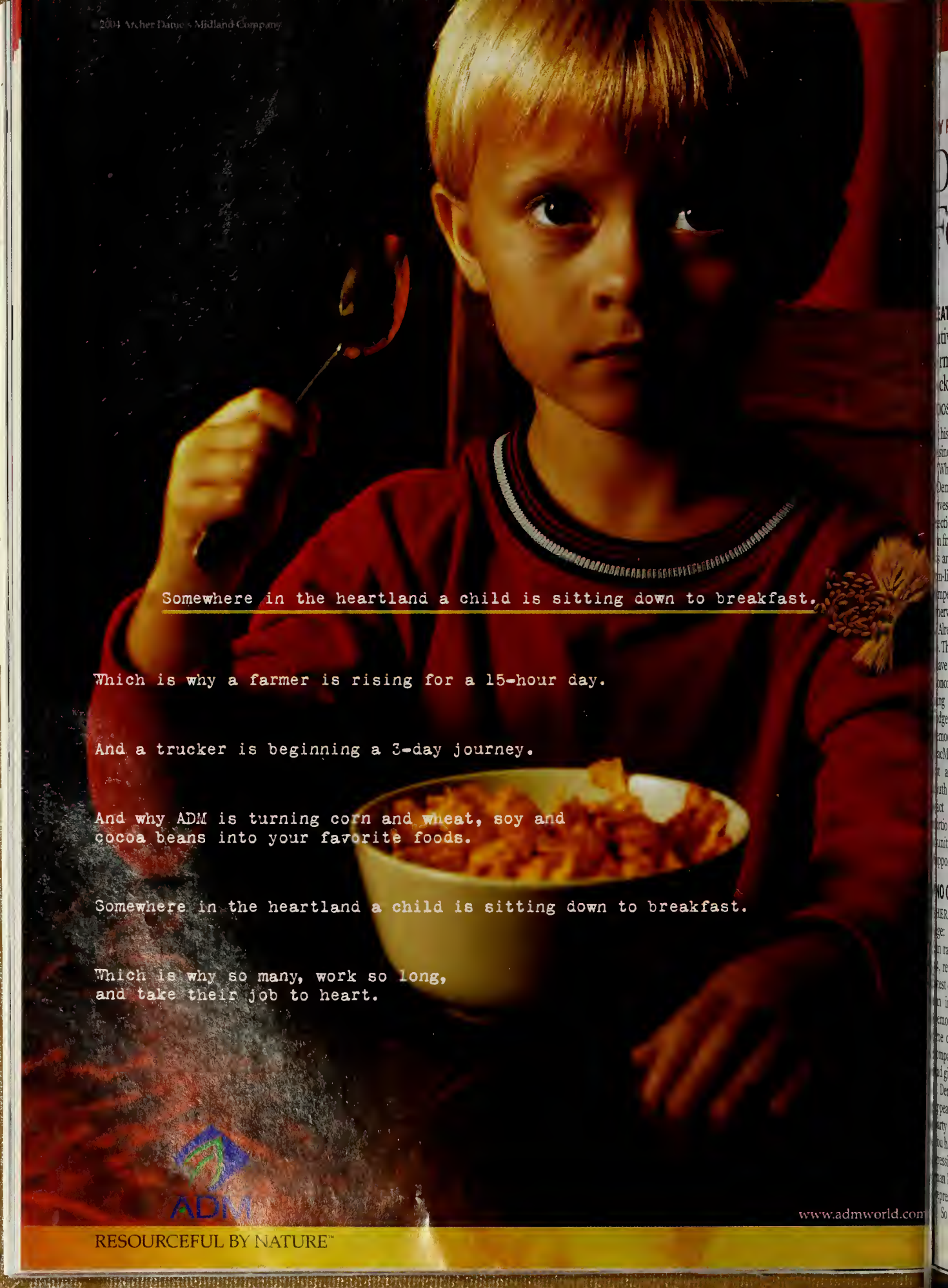
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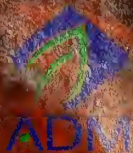
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RICHARD S. DUNHAM

Drumming up Business For the Democrats

MATH SHULER IS THE KIND OF CANDIDATE who appeals to the conservative voters in the mountains of western North Carolina. The former University of Tennessee football star and a top NFL draft pick has made millions in real estate and land development, boosting his payroll from 3 to 250 in just eight years. Now he has

his sights on a seat in Congress. "I'm pro-business, pro-life, and pro-gun," he says. What's so unusual about that? Shuler is a Democrat—one of several business executives joining the Democratic team for election '06. Faced with daunting Republican financial advantages, Democratic leaders are betting that candidates with both on-line experience can make their party competitive in a handful of districts that otherwise would lean Republican.

Already, eight new recruits have suited the business Democrats. They have an ability to talk about economic development, creating jobs, and balancing budgets in a way that other Democrats can't," says Susan MacManus, a political scientist at the University of South Florida. "They can attract swing voters and a portion of the business community that traditionally supports Republicans."

NO CHECKLIST"

THERE'S ANOTHER advantage: Business Dems often can raise big bucks. Shuler, reports \$248,957 cash on hand in his latest disclosure—vs. \$19,369 for Republican incumbent Charles H. Taylor. The Democrat's donor list crosses party lines. One contributor, Tennessee construction company chief executive Sidney A. Blalock, had given only to Republicans since 1999. Democratic bigwigs relish that crossover appeal—even if some recruits stray from party orthodoxy. "There's no checklist that you have to run on," says Democratic Congressional Campaign Committee Chairman Rahm Emanuel (Ill.). "They've got to represent their districts."

So while Shuler is a cultural conservative,

former Microsoft executive Darcy Burner is a pro-choice social liberal and a self-described "credentialed geek." That's a plus in suburban Seattle, where she is challenging freshman Republican Dave Reichert. Georgia Berner, CEO of a manufacturing company in New Castle, Pa., criticizes GOP incumbent Melissa Hart for backing trade deals that weaken U.S. manufacturers. And Russ Warner, who built one of the nation's largest magazine distribution companies, is running as a champion of entrepreneurs in a suburban Los Angeles district dotted with small businesses.

Backers don't always realize these candidates are Democrats. Christine Jennings went to work as a bank teller at age 17 and three decades later founded Sarasota Bank. Former Sarasota (Fla.) Mayor Mollie Cardamone, a longtime Republican, bought the bank's stock at \$10 per share in 1992 and sold it for

more than \$62 in 2003. When Jennings, 59, first declared for the seat of Republican Representative Katherine Harris, Cardamone was shocked to learn that the fiscal conservative was a Democrat. But she's so sold on Jennings that she switched parties to vote for the banker in the Democratic primary. "She appeals to moderate Republicans who can't support 'serious Democrats' who give away everything in the world," says Cardamone.

One of the business Dems, Timothy Mahoney, chairman of Boca Raton-based brokerage vFinance Inc., was a moderate Republican—until the national GOP moved further to the right. Now he thinks his compatriots have plenty to offer. "We understand this New Economy," he says. "We know a lot about creating jobs and building businesses." ■



SHULER A Democrat North Carolina's conservatives could love

CAPITAL INSIDER

SANTORUM: THE NEW FAVORITE OF BUSINESS

SENATOR RICK SANTORUM (R-Pa.) has never been considered a go-to guy for Big Business on Capitol Hill. After all, some corporate types are nervous about his blue-collar roots, his populist proclivities, and his emphasis on religious issues. So why has Santorum, the third-ranking member of the Senate Republican leadership, become the top recipient of campaign checks from the seven most generous economic sectors, including health-care companies, Wall Street, and commercial banks? The reason: Polls show Santorum trailing his 2006 Democratic challenger, Bob Casey, and he's calling in all his chips. Business clearly prefers a tax-cutting GOP populist to an old-school economic liberal. What's more, if the embattled incumbent survives Casey's challenge, business lobbyists know that Santorum could well run for President—and nobody wants to get on his bad side by sitting out the Senate race.

DON'T EVEN THINK OF FLYING HERE

VICE-PRESIDENT DICK Cheney has spent a lot of time in undisclosed locations, but he has a new, disclosed location where aircraft dare not go. The Federal Aviation Administration, at the request of the Secret Service, has banned flights within a mile of Cheney's new country home in St. Michaels, Md., on Chesapeake Bay—even when he isn't there. That creates a headache for some corporate executives, who have griped for years that their private planes have to dodge more and more no-fly zones surrounding the Washington area. Add one more to the flight chart.

EDUCATION

CHINA'S B-SCHOOL BOOM

Meet the new managerial class in the making

BY LOUIS LAVELLE



WALK INTO ANY classroom at one of China's elite business schools and what you're likely to see isn't all that different from what you would find at Harvard, Wharton, or MIT's Sloan School. True, there's a preponderance of Asian faces and the occasional smattering of Mandarin. But the classes, course materials, subject matter, and even the teachers are virtually identical to their U.S. counterparts.

Indeed, in most cases the MBA programs attended by China's top students are very much the product of Western educational institutions, which in recent years have rushed to establish programs on the mainland. The idea: to tap into the

enormous demand for talent created by China's white-hot economy.

The colossal effort by the central government of China to educate the nation's next generation of managers is unprecedented, and it has been undertaken with breathtaking speed. By adopting the U.S. model wholesale, Chinese B-schools have in just 15 years raced through an evolution that took U.S. B-schools more than half a century. "China is borrowing what it can and creating what it needs," says Patrick Moreton, co-director of the executive MBA program offered by Fudan University and Washington University in St. Louis' Olin School of Business.

The need couldn't be more urgent. Twenty-five years into China's transformation into a market economy, the nation

faces a critical shortage of well-trained managers. After two decades of explosive economic growth, many Chinese managers run regional or national companies yet they lack the sophisticated skills to compete effectively.

DOUBLE-EDGED SWORD

FOR U.S. COMPANIES, the emergence of China's new managerial class has positive and negative implications. For the seeking to penetrate China's massive market of 1.3 billion people, the graduates of the nation's new MBA programs will supply a steady stream of local talent with in-depth knowledge of China, something their Western managers can't provide. But as Western management ideas take root in the nation's corner offices, multinational firms could find themselves

CASE STUDIES First-year students at BiMBA program in Beijing talk shop



BiMBA
北大国际

onting a newly powerful adversary: Chinese companies suddenly in possession of the management knowhow needed to go head to head with global giants. Those same ideas—about efficiency, productivity, profitability, and growth—hold vast potential to ignite China's already blistering economy, raise living standards, and transform the nation from a low-cost manufacturing center to a make-or-break battleground for the global economy.

At the same time, given the vastness of China's needs, creating the new managerial class is an effort to keep its decades-long economic miracle roaring—a doubling-down of the bet Deng Xiaoping made in 1978 when he set China on the path toward capitalism. In all, China will require 75,000 top-level executives with global experience by 2010,

estimates McKinsey & Co.—about 70,000 more than it has now. Without them, the future is uncertain. “In the past, most Chinese companies were domestic. Now they have become global competitors,” says Zhang Weiying, dean of the Guanghua School of Management at Beijing University. “If they don’t have professional management training, they don’t survive.”

With demand for management talent outstripping supply, elite Chinese universities have rushed to fill the gap. Top schools, such as Tsinghua University in Beijing and Fudan in Shanghai, have joined forces with Western partners to offer state-approved MBA programs that have grown more than tenfold since 1991, when the government began licensing them.

Many Chinese students, most of whom once sought their MBAs in the West, now stay put. By earning degrees closer to home, they avoid derailing their careers—and losing business contacts—by leaving China for two years or more. Lured by the promise of big salary increases and coveted jobs with multinationals, they’re applying to B-schools by the tens of thousands. “China is changing so quickly,” says Nina Zou, 28, a recent graduate of China Europe International Business School (CEIBS) in Shanghai. “If I left now, I would be behind the curve because of what I had missed.”

In a strange reversal, Westerners who wouldn’t have considered a Chinese B-school a few years ago are flocking to them to stake a claim in the fastest-growing major economy on earth. In all, more than 18,500 students of all nationalities were admitted to about 90 Chinese MBA programs in 2004, including nearly 12,000 full-time students, a more than sevenfold increase in just seven years. After a recent two-year decline in applications, a favorable demographic shift has B-schools bracing for what could be another sharp rise.

To explore what’s behind the blossoming interest in man-

The best programs are virtually identical to those of Western B-schools

agement education, *BusinessWeek* undertook an exclusive survey of nearly 1,000 MBA students at 13 of China’s top programs—the vanguard of the new China. While they identified strengths and weaknesses in individual programs, the students were generally satisfied with the education they are receiving. Two-thirds say their MBA experience has surpassed their

expectations, and most give their programs high marks for teaching, course content, and career services.

STATESIDE SLUMP

NOT SURPRISINGLY, the survey found that students were overwhelmingly upbeat about China’s prospects and their own. More than half expect a sizable pay raise at graduation, about 25% intend to start a business in five years, and the vast majority plan to pursue careers in China. “The Chinese labor market is booming,” says Frank R.C. Wu, a recent CEIBS executive MBA (EMBA) graduate, over lunch with classmates. “Every one of us is optimistic.”

The intense interest in management education in China comes at a propitious time for U.S. B-schools. Now in the midst of a prolonged slump in applications at home brought on by a strong job market, skyrocketing tuition, and stagnating post-MBA salaries in the States, many are looking to China for growth.

At Massachusetts Institute of Technology’s Sloan School of Management, full-time applications in the U.S. have fallen over 30% since 2002, forcing the school to be less selective, accepting 20% of applicants in 2004, up from 13% in 2002.

But applications to MIT’s MBA program at Tsinghua have surged, tripling since the program’s launch in 1997—a pattern repeated at most Chinese MBA programs that have Western partners. Scott Koerwer, an associate dean at the University of Maryland’s Robert H. Smith School of Business, which started an EMBA program in Beijing in 2002, knows that only too well. “It’s not just our future growth

75,000

Number of execs with international experience that China will need in five years

5,000

Number it has today

Data: McKinsey & Co.

arena,” Koerwer says. “It’s our future.”

The B-school boom in China is not without problems, however. Beyond the top tier, the great majority of the nation’s B-schools are of poor quality. Many are taught in Mandarin by poorly trained Chinese faculty. Others are little more than diploma mills. At top campuses, the instructional method of choice is the case study. But a dearth of Chinese cases forces most faculty to use those prepared by Harvard Business School, which students say are of little use to people planning to pursue careers in China. And recruiters for multinationals say many graduates of even the top programs are ill-prepared, contributing to a marked decline in the value of the degree in the eyes of some recruiters. Meanwhile, PhD programs in management—which supply the faculty for MBA programs—are few, a sign that China’s grand experiment may not yet be self-sustaining.

Still, there’s no denying that the best schools, especially those with Western partners, give students a leg up on the competition. At programs such as Beijing International (BiMBA) at Beijing University, a joint venture with Fordham University in New York City, the Western partners contribute faculty, curriculums, and even books that are virtually identical to those on U.S. campuses. Classes are taught in English by borrowed professors. And the degree awarded at the end frequently comes from the U.S. university.

MAO NOT FRIEDMAN

IN CHINA’S NOT-TOO-DISTANT past, it wasn’t unheard of for management classes to include the teachings of Mao Zedong, while the teachings of Milton Friedman and Max Weber were nowhere to be found. Today there are few outward signs that the educational purpose of the university has been yoked to any political agenda. Most B-school curricula take up socialist economic theory in one form or another. At Shanghai Jiao Tong University’s Antai School of Management, MBA students are required to study Deng Xiaoping’s economic and managerial philosophy. But they also get large helpings of efficient-markets theory, along with occasionally heated debates over the harsher aspects of U.S.-style capitalism, such as mass layoffs. Says Michael Furst, a BiMBA associate dean: “This is not a place that advocates central planning. We’re talking about capitalism here. It varies by professor, but I’ve heard some of my colleagues who sound like Gordon Gekko.”

For Chinese students, such Western-style programs have enormous appeal.

Earning an MBA from a prestigious Western university without interrupting their careers, and the value of that degree in the Chinese job market, are huge pluses for a new generation of managers seeking to escape the tedium of China’s failing state-owned enterprises. These students are angling for exciting futures as entrepreneurs or for jobs with multinationals and fast-growing Chinese companies.

Many believe that the Western management techniques and leadership skills they’re learning will be squandered at state-owned enterprises, where promotion depends on seniority and top leadership is resistant to change. The bigger challenges and rewards are expected at multinationals. Indeed, many students believe that huge salary increases and multiple job offers await graduates of the Western programs—something that can’t be said for graduates of Chinese B-schools without Western partners.

In *BusinessWeek*’s survey, one out of four students said they expected to at least double their salaries after graduation, with expected increases averaging 78%. Graduates of the Rutgers International EMBA program, for example, can expect an increase of \$20,000, while those from Tsinghua’s international MBA program typically

ALL FROM COLUMN A
BiMBA lures the brightest, often from multinationals



ly receive \$16,000. Salaries have even been known to hit 1 million yuan, or \$125,000, roughly the U.S. equivalent of going to Harvard for two years and emerging as Donald Trump.

Trump never had it this hard, though. In fact, just getting into a leading Chinese B-school can be an ordeal. Due to a quirk in the way applications are han-

dled, students usually apply only to one school at a time, so rejection sets an aspiring manager back a year. And rejections are legendary. At BiMBA, for example, GMAT scores for incoming full-time students averaged 664 in 2003, on par with the University of Chicago and University of Michigan. At Tsinghua, only 16% of applicants were accepted in 2004, making it as selective as University of Pennsylvania’s Wharton School.

At the most selective schools, getting in is only half the challenge. At Tsinghua, first-year students often take eight courses a semester four to six is standard the U.S.—with several requiring a 50-page final paper. Fun, when there

Why China’s B-School Explosion Matters

- For U.S. B-schools that offer programs on the mainland, it might offset a three-year drought in applications
- Western management ideas could ignite productivity in China’s already white-hot economy
- A steady supply of well-trained homegrown management talent could help U.S.-based multinationals tap China’s enormous market
- With MBAs filling middle-management slots, regional and national companies will have what it takes to compete with global giants
- Equipped with diplomas from top Western B-schools, Chinese MBAs landing on Western shores will compete with U.S. grads for jobs and promotions



class, not realizing their main rival might be sitting a few seats away.

With many Chinese companies facing down global giants for the first time, businesses are sending executives to EMBA programs by the truckload and giving them free rein to put what they learn to use. Even state-owned companies are getting into the act. Four executives from Jilin Grain Group, an import-export company, now attend the University of Iowa program, and one of them used what he learned to overhaul Jilin's employee incentives.

Students say Western management techniques will help Chinese companies compete

against better-managed rivals. "Ten years ago the gap between Chinese companies and multinationals was huge," says Alan Wang, a CEIBS EMBA student in Shanghai and an exec at one of China's biggest ice-cream makers. "Now everyone in China is aware of how important an MBA education is, and we're quickly filling that space."

As in the U.S., B-school in China is a ticket to affluence—but granted only to a select few with large sums of cash for tuition and living expenses. In China, MBA costs can top \$25,000, while EMBA programs can exceed \$45,000, costs that students themselves increasingly are paying as companies balk at shelling out large sums for workers who may not stick around. Many students say they borrow from family to make ends meet. In the

Unlike in the U.S., most EMBA students in China are senior execs

survey, students who borrowed had average debts of about \$20,000. One student reported he was on the hook for \$55,000.

Despite the talk of million-yuan salaries, the return on that investment is not what it once was. China's booming economy has made taking two years off for an

MBA an expensive proposition. Popular executive education programs have given employers a low-cost alternative to hiring MBA graduates. And an abundance of low-quality MBA programs churning out graduates with few discernible job skills has left many employers wary.

Even at top programs there's a palpable sense of disappointment among recruiters, who say many graduates lack adequate English skills, problem-solving abilities, and a willingness to start at the bottom. MBA expectations are being lowered. Linda Shi, human resources director for Cummins China Investment Co., the diesel engine manufacturer, says the two MBAs it recruited this year started in entry-level jobs. "In the past few years, MBAs had high expectations. Now they anticipate they will start at the entry level and that we will pay reasonably," says Shi.

With the percentage of high school students entering college on the upswing, from 11% in 1998 to 19% today, many deans believe China will soon see a surge in enrollments that will transform the MBA from an academic curiosity into a must-have degree. "When more people have a telephone, more people buy a telephone. The value increases," notes Guanghua's Zhang. "If you have no MBA degree, you can't find a job."

If Zhang is right, China could be headed for a virtuous circle. The more the MBA comes to be viewed as the price of admission to the ranks of senior managers, the more MBAs China will produce, and the economic consequences will be profound. Can China create world-class MBA programs to challenge the pre-eminence of the Kelloggs, Whartons, and Harvards of the world? It has a long way to go, but none of the top-ranked U.S. B-schools should rest easy. ■

—With Susann Rutledge
in New York

ie, is most likely an impromptu soccer match or basketball game—or another future. Says Ruipeng Di, a corporate finance professor in the Tsinghua/UT IMBA program: "This place is pretight."

As popular as MBA programs are, EMBA programs may be more so. Unlike in the U.S., where EMBA programs draw mostly midlevel up-and-coming managers, EMBA slots in China go to the nation's most senior executives. Over 60% of the 550 students in the CEIBS EMBA program are chief executives, chairmen, presidents of their companies. Part of the draw is a chance to learn Western techniques they can put to immediate use at their own companies. But students also use EMBA classes to negotiate business deals, hire talent, and even form new companies.

SIDE INFO

THE CONCENTRATION of big business is sometimes difficult to manage. At an executive MBA program in food and agribusiness offered by the Chinese Academy of Agricultural Sciences and the University of Iowa's Henry B. Tippie School of Management, school officials say, one student tried to send his secretary to finish out the program after attending just a day of classes. And students sometimes come close to divulging company secrets in

China B-Schools from A to Z

The Survey: Top MBA & Executive MBA programs, including student comments.

The Data: Statistical profiles of individual MBA and executive MBA programs.

The Deans: Q&As with deans at top programs.

The Campuses: Slide-shows of campus life at Tsinghua University, Beijing University, and other elite schools.

And More: Exclusive online stories about executive education, team teaching, community service, and other aspects of business-school life in China.

BusinessWeek online

www.businessweek.com/bschools/China/

EDITED BY ROSE BRADY

Ukraine: Shaky Ground For Foreign Investors

WHEN UKRAINIANS ELECTED Western-oriented reformer Viktor Yushchenko as President last December, hopes ran high for radical economic improvements. A former central banker with liberal views, Yushchenko, had promised to fight corruption and regulatory burdens on business and to promote greater openness

to foreign investment. Yet one year after his victory, the breakthrough has yet to occur.

The Orange Revolution has certainly had its achievements. The media, formerly tightly controlled, can now report freely. Yushchenko can also point to economic gains, notably the October privatization of steel mill Kryvorizhstal, which fetched \$4.8 billion when it was auctioned to Mittal Steel Co., the world's largest steelmaker. In October, Austria's Raiffeisen Bank paid \$1 billion for Aval Bank, Ukraine's second-largest. "Political risk has declined, and investors are much more confident," says Tomas Fiala, managing director of Kiev brokerage Dragon Capital.

Yet while Ukraine is looming larger on investors' radar screens, reforms have been slow and the country's economic performance has deteriorated. Gross domestic product likely grew by little more than 3% in 2005, far below the previous year's 12%. The cooling in part represents a fall in the price of steel and other metals, Ukraine's chief exports. But the economy also hasn't been helped by the policies of Yushchenko's first Prime Minister, Yulia Tymoshenko, dismissed in September after infighting within the Orange camp. She spooked business with interventionist measures such as promises to renationalize Ukrainian companies sold off under the previous regime. "It was very much a [command] control economy," says Garry Levesley, Ukrainian director for U.S. power company AES Corp. "The results from the business perspective were not good."

In contrast, current Premier Yuri Yekhanurov has helped to restore confidence by

saying he's against renationalization. The snag is that his government is little more than a caretaker until parliamentary elections in March, which will determine the next government's makeup. The stakes are high because of constitutional changes that come into force on Jan. 1. Under these rules, ministers, including the Prime Minister, will be appointed by the parliamentary majority rather than by the President.

Public disappointment

THE CHANGE could spell more trouble for the President. The pro-Yushchenko bloc faces competition from not only Tymoshenko's party but also from the party led by Viktor Yanukovych, the defeated candidate in last year's presidential election. Public disappointment with the revolution has meant rebounding support for the opposition. A recent poll by the Ukrainian Sociological Service put Yushchenko's party in third place, with 12.2% support.

Any governing coalition will have to include two of the three major parties, forcing Yushchenko's supporters either to team up with Tymoshenko or form an unholy alliance with the Yanukovych camp. If Tymoshenko wins more votes, she's sure to make her support conditional on participation in the new government. Analysts believe she hopes to get back her old job as Premier, risking a return to interventionist policies. With the President's powers clipped, the revolution's supporters split, and an uncertain battle ahead, no one should take the Orange Revolution's progress for granted. ■

—By Jason Bush in Kiev



YUSHCHENKO
Polls show his party is in third place

WORLD WRAPUP

JAPANESE SPREE

DECEMBER IS a busy month for shoppers the world over. But in Japan this year, it's the retailers themselves who have been the biggest spenders.

On Dec. 21, Wal-Mart Stores Inc. spent \$565 million to raise its stake in struggling Japanese retailer Seiyu to 53%. Trading house Marubeni and Advantage Partners, a private equity firm, finalized plans on Dec. 27 to raise their holding in supermarket chain Daiei to 67.7%. But the season's largest deal involves Seven & I Holdings, which owns Ito Yokado superstores and Seven-Eleven convenience stores in Japan and the U.S. On Dec. 26, Seven & I announced that it is spending \$1.1 billion to buy an initial 65% stake in Millennium Retailing, owner of the Seibu and Sogo department stores, in a move that will create Japan's largest retailing conglomerate, with sales of \$38 billion.

DON'T FENCE ME IN

A WINTRY chill has hit relations between the U.S. and Mexico. Just before the holiday break, the U.S. House of Representatives O.K.'d a plan to build 700 miles of high-tech fences along its southern border to keep out illegal migrants. The legislation, which the Senate is due to take up in February, would also make illegal entry into the U.S. a felony.

Mexican President Vicente Fox has called the legislation "disgraceful." And the Mexican Congress is lobbying lawmakers in other Latin American nations, along with those in Spain and Portugal, to oppose the fence. Peru, Honduras, and Guatemala have already signed on. So has Venezuelan President Hugo Chávez, a move which isn't likely to sway his many critics on Capitol Hill.

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COVER STORY



FRESH FIELDS

Otellini will soon unveil a new logo and a host of new products



INSIDE INTEL

Paul Otellini's plan will send the chipmaker into uncharted territory. And founder Andy Grove applauds the shift

By Cliff Edwards

EVEN THE GENTLE CLINKING of silverware stopped dead. Andrew S. Grove, the revered former Intel Corp. chief executive and now a senior adviser, had stepped up to the microphone in a hotel ballroom down the street from Intel's Santa Clara (Calif.) headquarters, preparing to respond to a startling presentation by new Chief Marketing Officer Eric B. Kim. All too familiar with Grove's legendary wrath, many of the 300 top managers at the Oct. 20 gathering tensed in their seats as they waited for a tongue-lashing of epic proportions. "No one knew what to think," recalls one attendee.

The reason? Kim's plan, cooked up with new CEO Paul S. Otellini, was a sharp departure from the company Grove had built. Essentially, they were proposing to blow up Intel's brand, the fifth-best-known in the world. As Otellini looked on from a front table, Kim declared that Intel must "clear out the cobwebs" and kill off many Grove-era creations. Intel Inside? Dump it, he said. The Pentium brand? Stale. The widely recognized dropped "e" in Intel's corporate logo? A relic.

Grove's deep baritone, sharpened by the accent of his native Hungary, pierced the expectant silence. But instead of

THOMAS BROENING

smiting the Philistines, Intel's patriarch sprinkled holy water on Otellini's plan. He understood that it was no repudiation of him, but rather a recognition that times had changed—and that Intel needed to change with them. "I want to say," he boomed, "that this program strikes me as one of the best manifestations incorporating Intel values of risk-taking, discipline, and results orientation I have ever seen here. I, for one, fully support it."

As executives rose to greet him with relieved applause, the moment signaled an historic shift for one of the world's most powerful technology companies. The iconic Intel would leave the Grove era behind and head into uncharted territory. Otellini will unveil the new strategy and new products on Jan. 5, at



BOLD Guiding the change is marketing chief Kim

COMPANY, KIM SAYS: "CLEAR OUT THE COBWEBS." AND THE "INTEL INSIDE" TAGLINE? DUMP IT

the Consumer Electronics Show in Las Vegas. Central to the effort will be the first new corporate logo in more than three decades and a \$2.5 billion advertising and marketing blitz, *BusinessWeek* has learned.

The changes go far deeper than the company's brand. Under Grove and successor Craig R. Barrett, Intel thrived by concentrating on the microprocessors that power personal computers. By narrowing the company's focus, the duo buried the competition. They invested billions in hyperproductive plants that could crank out more processors in a day than some rivals did in a year. Meanwhile, they helped give life to the Information Age, with ever-faster, more powerful chips.

Otellini is tossing out the old model. Instead of remaining focused on PCs, he's pushing Intel to play a key technological role in a half-dozen fields, including consumer electronics, wireless

communications, and health care. And rather than just microprocessors, he wants Intel to create all kinds of chips, as well as software, and then meld them together into what he calls "platforms." The idea is to power innovation from the living room to the emergency room. "This is the right thing for our company, and to some extent the industry," he says. "All of us want [technology] to be more powerful and to be simpler, to do stuff for us without us having to think about it."

Why the shift? Stark necessity. PC growth is slowing, even as cell phones and handheld devices compete for the *numero uno* spot in people's lives. Otellini must reinvent Intel—or face a future of creaky maturity. Revenue growth has averaged 13% for the past three years, but analysts figure Intel will see only 7% growth in 2006, to \$42.2 billion. Meantime, profits, which have surged an average 40% annually over the past three years, are expected to rise a measly 5%, to \$9.5 billion. "It's a race for Intel and other companies to figure out how fast is revenue going to come from emerging areas before PC margins begin to come down sharply," says Ragu Gurumurthy, head of technology practice for Boston tech consultancy Adventis Corp.

20,000 New Faces

INTEL HAS TRIED ENTERING NEW markets in the past, particularly under Barrett. Yet it always treated them as tangential and never let them detract from the core processor effort. Not anymore. Otellini, who took over as CEO in May, has reorganized the company top to bottom, putting most of its 98,000 employees into new jobs. He created business units for each product area, including mobility and digital health, and scattered the processor experts among them. He has also added 20,000 people in the past year. The result? Intel is poised to launch more new products in 2006 than at any time in its history.

Intel's culture is changing, too. Under the charismatic Grove, who was CEO from 1987 to 1998 and then chairman until 2005, the company was a rough-and-tumble place. Grove's motto was "Only the paranoid survive," and managers frequently engaged in "constructive confrontation," which any outsider would call shouting. Engineers ruled the roost. Grove and Barrett also instituted the practice of doling

AS FOR GROVE'S VISION OF THE

out cash to PC makers for joint advertising, which Intel rivals have alleged blocks them from some markets.

Otellini is more diplomatic, partly by nature, partly by necessity. The intensely private 55-year-old rarely reveals irrita-

tion—and then, with a slight frown. His management mantra: "Praise in public, criticize in private."

He's also the first non-engineer to run the company. Otellini studied economics in college at the University of San Francisco and then joined Intel in 1974, straight out of B-school at the University of California at Berkeley. Many of the new employees he's bringing on aren't typical Intel hires either. They include software developers, sociologists, ethnographers, even doctors to help develop products. He lays particular emphasis on marketing expertise because he thinks the only way Intel can succeed in new markets is by communicating more clearly what the technology can do for customers. "To sell technology now, you have to do it in a way where it's much more simple," says Otellini. "You can't talk about the bits and the bytes."

The changes have created some angst among employees. In

particular, many high-level engineers working on PC products and they've been stripped of their star status. "The desktop group used to rule the company, and we liked it that way," says one former chip designer, adding that some engineers now feel "directionless." Other employees are simply uncomfortable with the new emphasis on marketing. "There definitely are people who are highly skeptical, who think this is all fluff, all just gloss—that if you make good technology, you don't need the glitz," says Genevieve Bell, an in-house ethnographer who researches how people in emerging markets like China and India use technology. Yet Intel and Otellini aren't shying away from glitz these days. For its bash at the Consumer Electronics Show, the com-

pany has booked the hip-hop band Black Eyed Peas, with its hit *Let's Get It Started*. Beforehand, Otellini will unveil the new Intel during his keynote speech. It starts with a whole new look for the 37-year-old company. The Intel Inside logo will disappear, replaced by an updated Intel logo with a swirl around it to signify movement. For the first time since the early 1990s, the company will add a tagline: "Leap ahead."

Meantime, the famous Pentium brand will be slowly phased out. In its place: a troika of brands, two of them freshly minted. Viiv (rhymes with "alive") is the name of a new chip for home PCs, designed to replace your TiVo, stereo, and, potentially, cable or satellite set-top box. It will be able to download first-run

REMAKING INTEL FROM TOP TO BOTTOM

Marketing is becoming as important as engineering, a big shift for the company Grove founded



ANDY GROVE'S INTEL

"Only the paranoid survive"

CEO from 1987 to 1998, Grove is best known for the high-stakes decision to leave the money-losing memory-chip business and focus on developing microprocessors for PCs and servers. That helped Intel bury its competition, with ever-faster processors.

Created the Pentium and "Intel Inside" branding that highlighted the computer's guts for first time.



Direct and confrontational. His shouts echoed down company halls.

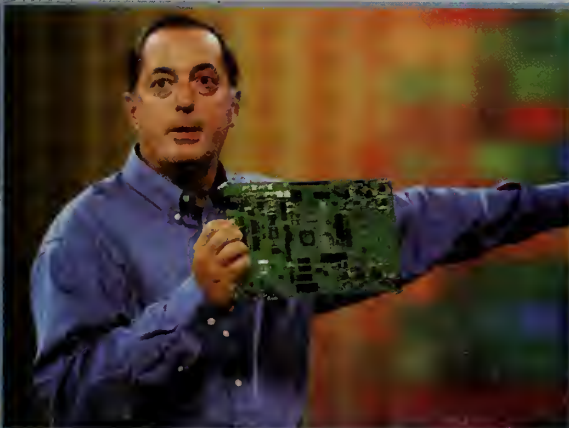
Working closely with Microsoft, Intel concentrated on wooing PC industry giants such as Dell, Compaq, IBM, and HP.

Engineers ruled, based largely on their skills running divisions within the core PC business.

A Hungarian Jew whose family narrowly escaped the Holocaust and later fled the Iron Curtain.

Instituted "signing sheet" for people who were more than five minutes late for work.

Headquarters cafeteria offered stale sandwiches, bland food.



PAUL OTELLINI'S INTEL

"Praise in public, criticize in private"

Otellini says that Intel has to move beyond microprocessors and that speed alone is no longer enough. Instead, he wants to create "platforms" of microprocessors combining silicon and software that lead to new devices and technologies.

Created the "Leap ahead" logo, Intel's first new corporate logo in more than 30 years.



Direct, with encyclopedic knowledge, but so soft-spoken you sometimes strain to hear him.

Everyone and everything, from Cisco in networking to Motorola for mobile devices to hospitals for digital health.

Marketers and even ethnographers are on equal footing with chip engineers

Son of Italian immigrants who initially wanted him to become a priest in San Francisco.

A decentralized organization where BlackBerrys and e-mail are the primary ways to reach employees.

A revamped canteen, which now serves up sushi and made-to-order lunches.

movies, music, and games, and shift them around the home. Intel also will launch a set of notebook PC chips under the three-year-old Centrino brand, as well as so-called dual-core chips, which will put two processor cores on one sliver of silicon. The new brand "Core" will be put on products that don't meet the specifications of the Viiv or Centrino platforms. The effort is winning high-profile support. On Jan. 10, Apple Computer Inc., which has never used Intel's chips before, is expected to be one of the first companies to offer products with the dual-core chips.

One of Otellini's key steps in all this was hiring Kim away from Samsung Group a year ago. Kim had led Samsung's marketing since 1999 and helped build the Korean maker of consumer electronics, cell phones, and computer chips into a hot global brand. But Otellini didn't just swipe a major talent away from the company that's increasingly seen as Intel's prime competitor. By hiring an outsider who reports directly to the CEO for the first time in Intel's history, Otellini also got someone who could play bad cop and push through unpopular changes when necessary. Rank-and-file employees do grumble about Kim and what they consider his autocratic style, but he makes no apologies. "I tell people they're not just about making silicon. They're helping people's lives improve, and we need to let the world know that," says Kim.

Yet it's a daunting task, especially for a company that has never had much success outside the computer industry. Companies that have been good at transforming themselves, from Nissan and Apple to Texas Instruments, typically need a crisis to precipitate change, says management expert Jay R. Galbraith of Galbraith Associates. And although Intel is facing a possible slowdown, it's still pulling in nearly \$1 billion a month in profits. "Change is really hard when you're solidly on top," says Galbraith. "He'll have to bring in new people who have new skill sets."

A Mean Pack

COMPETITORS KEEP nipping at Intel's flanks. Longtime rival Advanced Micro Devices Inc. in 2003 launched its Opteron and Athlon 64 chips, outgunning Intel in both raw power and lower power consumption. AMD's market share rose to 17.8% last quarter, up from 16.6% in early 2003, and some analysts predict it will gain more until Intel fields competitive chips in late 2007. AMD CEO Hector J. de Ruiz equates Intel's position with that of American auto makers, scrambling to find innovation even as consumers flock to Japanese rivals. "People are smart enough to

SWEET
Jobs announcing
Apple's switch to
Intel chips



INTEL'S GOAL: TO PROVIDE TOTAL PACKAGES OF CHIPS AND SOFTWARE TO MAKERS OF LAPTOPS, PCs, CELL PHONES, AND MEDICAL GEAR

pick quality when given a choice, and calling something a platform doesn't guarantee quality," Ruiz says.

In the cell phone market, Texas Instruments and Qualcomm Inc. have held fast against Intel's incursions. Intel Executive Vice-President Sean M. Maloney once wore snowshoes to a company sales conference to illustrate the deep slog. In 2006, AMD and TI plan to field their own chip platforms aimed at capturing some real estate in the digital home.

So Otellini is shaking things up throughout the company. In addition to the reorg, he's making big changes in the way products are developed. While in the past engineers worked on ever faster chips and then let marketers try to sell them, there are now teams of people with a cross-section of skills. Chip engineers, software developers, marketers, and market specialists all work together to come up with compelling products.

One example of the new approach is Bern Shen. A doctor who practiced internal medicine for 15 years, he joined Intel three months ago to help develop technologies for digital health. He works with Intel's ethnographers to figure out which technologies might help in monitoring the vital signs of the elderly or tracking the diet of people with Alzheimer's. "The fact that they hired me is an indication of the new Intel," he says.

Otellini is convinced such collaboration will lead to breakthrough innovations. He imagines a day when people will use Centrino laptops to watch live TV on the subway or when kids will be able to download *Spider-Man 3* to their home theater on the same day it's released worldwide. Shen's work could lead to Intel technology that allows the elderly to keep living at home even as data on their vital signs are zapped to doctors several times a day. "This is the right model," Otellini says. "Now it's just a matter of playing it out."

If the world buys Otellini's ideas, industries from Hollywood to health care could be turned upside down. Media and entertainment may be forced to rethink their business models. Th

Intel Online

Otellini on the Record An extended interview with Intel's president and CEO on the risks and potential rewards of organizing the world's largest chipmaker around end-user products over PCs.

Intel in Israel The A-team of microprocessor designers works at Intel's Haifa facility. What's their secret?

The Story Behind the Story For a podcast interview with Correspondent Cliff Edwards by Assistant Managing Editor Frank Comes, go to businessweek.com/search/podcasting.htm



BusinessWeek online

<http://www.businessweek.com/extras>

health industry could be transformed, as doctors diagnose or even treat patients remotely. "The most important thing about Intel is that they've got the vision," says Russ Bodoff, executive director of the Center for Aging Services Technologies (CAST), a coalition of 400 companies, universities, and hospitals. "They are pushing some very innovative approaches, in areas that relate to dementia, Alzheimer's care, and Parkinson's disease."

The ultimate goal: to provide the manufacturers of everything from laptops and entertainment PCs to cell phones and hospital gear with complete packages of chips and software. The template is Centrino. When Otellini was leading product marketing in the core PC business from 1998 to 2002, he decided that rather than roll out just another fast processor, he would bundle it with a relatively new wireless Internet technology called Wi-Fi. The combo made it a breeze for people to connect to the Net from airport lounges and coffee shops. Backed with an initial \$300 million marketing campaign, Centrino notebooks became an instant hit, revitalizing the PC market and persuading consumers to snap up the higher-margin products.

Now, a Giant Step

WELL, INTEL'S FIRST big success in diversification was only a half-step away from the core PC market. Will it be able to do as well in other areas? Consider Viiv. In the consumer electronics market where Viiv devices will be positioned as an all-in-one DVD player, game console, TiVo, and music jukebox, it faces plenty of big-name competitors. Meanwhile, brand-new challengers are appearing on the horizon. Sony Corp., with its PlayStation 3 due out in just a few months, aims to offer games, movies, and music on the device, which uses chips from IBM. Cable and satellite providers such as Comcast Corp. and DirecTV Group Inc. are adding more features and services to their set-top boxes, such as on-demand television shows and XM satellite radio.

Cutting through the clutter of competitive activity is why Otellini and Kim have lifted branding to new heights at Intel. For a huge company like Intel, it will be especially tough. In many ways, it's like trying to change the engines on an airplane when you're flying it," says Russ Meyer, chief strategy officer for branding consultancy Landor Associates. Companies must try not only to differentiate themselves from competitors but also to align internally to make sure the same message is clear to employees. For an "ingredient" brand like Intel with no products that a consumer actually can pick up from the local Best Buy or Wal-Mart, the trick also is to convince new customers of the value of using its products.

With that in mind, Otellini's Digital Home team has struck one of the biggest content deals to date with major Hollywood players and music services to entice both customers and consumers to the Viiv platform. The hundreds of millions it will dole out for marketing Viiv has partners like Sony and Philips Electronics salivating. They also seem to be genuinely impressed with the new attitude at Otellini's Intel. "I have seen more flexibility, more of an open mindset than in years past," says Sony Vice President Mike Abary, who heads the company's Vaio PC business. "They realize that times have changed, that they don't have all the answers. So it has been much more collaborative working with them."

Otellini also has gone to great lengths to win over marketing maestro Steve Jobs. It's quite a reversal. For years, Grove and Barrett pooh-poohed Apple as a niche company whose products had sleek form, but nowhere near the function of computers with Intel's chips. Yet Otellini set about wooing Jobs almost from the

INTEL'S BIG BANG

This year, Intel will roll out more new products than ever before. Here's what to expect:

NOTEBOOKS

Intel plans to introduce three new chips for laptops. One, called **Core Duo**, consumes less power—so notebooks can run for 5 to 10 hours, instead of the typical three or four. Another chip will offer consumers the ability to communicate wirelessly at longer ranges.

Prognosis: Excellent. Intel should continue to dominate the laptop market. Already, its January launch of the Core Duo has the support of three times as many PC makers as the preceding chip.



PCs

Intel is looking to win a place in your living room, with its new **Viiv** chips. One Viiv entertainment PC will mimic a TV, complete with remote control and surround-sound technology. Another Viiv computer, expected by year-end, will let consumers connect PCs to DVD players, TVs, and stereo tuners so they can shift digital content around the home.

Prognosis: Good. Viiv has won early buzz, with Sony, Philips, and Dell creating snazzy new PCs with the technology. Consumer electronics maker Onkyo is launching its first-ever PC with Viiv.



SERVERS

Intel will introduce a new chip that promises to lower the bills for electricity consumption, a primary problem for corporate customers that maintain thousands of servers in data centers.

Prognosis: Mixed. Rival AMD continues to gain share in servers with its 64-bit Opteron chips and is likely to extend those gains until at least 2008, when Intel launches a totally revamped server platform.

WIRELESS

Intel will roll out chips to power cell phones and devices such as BlackBerrys, plus new memory chips for high-end cell phones and Apple's iPod. Longer term, the company plans to use wireless to move into the digital health market. One example: It's developing sensors that can communicate with computer networks, so caregivers can monitor the health of senior citizens remotely.

Prognosis: Difficult. Qualcomm and Texas Instruments are expected to continue to lead the market for cell-phone chips. Also, it's early yet for its digital health efforts. Intel should gain some ground in memory chips, however, given its strong technology.



BLACKBERRY 8700C



ENGINEER
Eden helped
spearhead the
Centrino launch

start. In June, a month after Otellini took over, the two companies announced Apple would begin shipping Macs and other products with Intel chips inside in 2006. Otellini aims to use the Apple relationship to force PC makers to step up their innovation. "They've always been a front-runner in design," he says. "As they start taking advantage of some of our lower-power products, that form factor will improve significantly. I think it will help drive a trend toward smaller, cheaper, cooler."

Jobs's influence extends beyond design. At Otellini's urging, Apple's "Think Different" vernacular is beginning to take root inside Intel. The two chief executives also appear to be developing a real friendship. Intel insiders say they talk regularly. And when Prince Charles and his wife, Camilla, visited Silicon Valley in late November, Jobs and Otellini were side by side, hobnobbing with the royals.

The Apple relationship could create some strain with Intel's two old *compadres* in the PC business, Dell and Microsoft. Dell has been one of Intel's most loyal customers: It's the only major U.S. maker of PCs that hasn't come out with boxes powered by AMD chips. So if Intel provides strong support for Apple in the PC business, it could prompt Dell to do business with AMD's Ruiz. Dell is going after more consumer business, Apple's primary turf. In late 2005, Dell introduced a higher-end XPS line and it plans to ship Viiv PCs.

Meantime, Intel execs seem open to easing their once iron-clad ties to Microsoft. At the start, PC makers will have to use Microsoft's Windows Media Center Edition operating system to earn the Viiv brand—and Intel's co-marketing dollars. But Intel says this may not continue, opening the door to Viiv machines with the Linux open-source operating system or even Apple's. Indeed, Kim says he ex-

pects some PC companies to ship Viiv boxes, without Windows

Another budding relationship in Intel's march on new markets is with Google. Otellini joined the search company's board in April, 2004, and has found a few areas of joint interest. For one, Otellini heard that Google's energy bill for its servers now exceeds the cost of the equipment. (With 100,000 servers Google's electricity bill probably tops \$50 million a year.) That prompted Otellini to explore the prospects for energy-efficient chips. In August, Intel announced it would dump its old architecture in favor of lower-power chips in 2006.

The two companies also have a shared interest in wireless broadband. Google is exploring whether to set up free Wi-Fi "hot spots" in San Francisco and other cities. Footing the bill for Net access may make sense for Google, since it allows the company to show digital ads to any Web surfers who use the service. Intel would benefit because free Wi-Fi could further the sales of Centrino laptops. Google execs have also said they're interested in WiMax, another wireless technology Intel is backing. Intel plans to imbed WiMax, which is similar to Wi-Fi but works over greater distances, into PC chips late this year.

Outsiders Welcome

TO BOLSTER THE PUSH, Otellini is looking to recruit more execs from outside the company. In the past year, Maloney hired Nokia Corp. veteran Steven Gray as a key member of the cellular team. And Maloney is turning more often to Intel Vice-President Sam Arditi, a cellular industry veteran with experience in radio chips and processors—key ingredients in handsets.

The result: closer ties with Nokia and Samsung, which are both collaborating with Intel on WiMax. In September, Maloney also announced a deal with Research In Motion Ltd., making it the first major name to use its cellular platform of radio processors, and memory. "The relationship is going to be very important to RIM," says co-CEO Jim Basillie.

For all that, Otellini's internal challenges may prove more daunting than the external ones. For one, PC chip development still casts a long shadow at the company. During Grove's and Barrett's tenures, anyone not producing for the core PC business was considered a second-class citizen. Barrett described the problem as akin to the creosote bush, a tall desert plant that drips poisonous oil, killing off all vegetation that tries to grow nearby. Microprocessors so dominated the company's strateg-

PLAYBOOK: BEST-PRACTICE IDEAS

LESSONS FOR BLOWING UP YOUR BRAND

Intel, like Coca-Cola and Sony, is struggling to redefine its brands in an age of increasing media clutter. Here are some guidelines for how to manage such an overhaul:

PRIME THE PUMP First, make sure the leaders of the company understand the new brand. They will be key to explaining the brand message to the rank and file.

DO YOUR HOMEWORK It's critical to stay on top of consumer habits as you evolve. Focus groups work, up to a point, but think about using new research techniques such as ethnography to watch how consumers use your products—and those of rivals.

TREAD CAREFULLY Don't change your brand unless you can clearly and concisely highlight the differences from competitors. Otherwise, you risk losing your core customers.

THINK GLOBALLY What works in one geographical area may not work in another. Identify the emotional attachment people may have to your brand in a particular region, and consider whether it translates to others.

change + hp



invent

How to light up a supply chain

Advance Transformer, a leading component manufacturer for lighting systems, had legacy IT systems that no longer kept up with production demands. They turned to HP to better manage their supply chain. Now, using an IT Service Management approach with HP OpenView software and HP BladeSystem servers, their systems automatically solve problems as they occur. All this has reduced production time from 28 to 5 days, cut inventory levels by 50% and revealed the bright side of change. www.hp.com/adapt

Solutions for the adaptive enterprise.

he says, that other businesses could not sprout around it. That was one reason Otellini reorganized into product areas.

The shake-up hasn't helped company morale, though. Especially hard-hit were the engineering teams in California and Texas, which had been working on the Pentium 4 until Otellini canceled it. Some of the design specialists have quit for new jobs, often with AMD or TI. To smooth over the troubles, Otellini has toured the chipmaker's outposts, talking with engineers and others without their managers around. "A lot of what he heard was pent-up frustration, no doubt," says one engineer. "But you appreciate the fact that he's listening." Intel's attrition in 2005 was 4%, about average for the tech industry.

Sniping about the rise of marketers such as Kim continues.

Says Schmuël "Mooly" Eden, an Israeli engineer who helped spearhead the Centrino launch and now heads marketing for the Mobility Group: "When I went back to Israel to talk to some of the engineers, they said: 'You're only one year in marketing, and already you're brain-damaged.'"

As Intel gears up for its big bang of product launches, there's no doubt the mantle of leadership has shifted. This year, Otellini, for the first time, will write a performance review for Grove. In his advisory role, Grove sits in on important meetings, particularly in digital health, and gives his thoughts. Asked about the prospect of critiquing the company legend, Otellini just laughs. Reviewing Grove will be a breeze next to the challenge of remaking the world's largest chipmaker. ■

OF APPLES AND BLACKBERRYS

In early December, Paul S. Otellini outlined for the first time some of the historic changes—and challenges—he faces in remaking Intel. After a speech at a conference in San Francisco, he spoke with technology correspondent Cliff Edwards.

On exiting the PC era:

The era we're going into now is one where as computing becomes more ubiquitous, and as it becomes more pervasive and has more uses, computers are going to become tailored to the needs. Whether you call an iPod a computer or not, or you call my BlackBerry a computer, it doesn't matter. They're going to be devices you can program, and they'll do something. The product lines that we are addressing today... are all focused on where we think computing is headed in the next four, five years.

On dropping the Pentium brand:

Pentium was the quintessential product of the era of megahertz. It stood for "faster is better." I wanted to signal a shift. Going forward, the paradigm is going to be increasingly portable machines, increasingly energy-efficient machines, increasingly smaller... Changing the name of our products goes a long way to putting an exclamation point on the design change behind them. Is it orthodox to walk away from one of the most recognized brand names in the world? Probably not. I don't think we'll walk away from it overnight.

On its plans for health care:

In digital health, we're just trying to play catch-up. [Health care takes up]

15% of GDP in the U.S. and [there are predictions] of going beyond 25% by 2015. To think that a quarter of this country's GDP would be dedicated to health care is a scary proposition. That 10 points has to come out of something: the education system or military. By applying productivity, I think we can really drive service up and costs down. Just like any other industry.



On Apple, which will use Intel chips in its PCs for the first time in 2006:

At the end of the day, we live to sell chips. First and foremost, it's market-expanding for us. Secondly, the thing that Apple really brings to the Intel family of customers is their innovation. They are a hugely innovative company and really push the envelope in terms of feature sets. Their ability to not just mix hardware and software, which is unique, but also to drop software upgrades rather frequently to take advantage of hardware changes, that alone is very appealing. The hardware will have the receptacle for software.

On whether to pay out more dividends:

We have the luxury of being a company that generates a lot of cash. To the extent we don't use it for expansion, I think we have an obligation to give it back to shareholders. On the other hand, if we have an opportunity to use cash, we'll certainly grab it.

Will Intel go out and make acquisitions?

We actually bought a lot of companies this year. I don't know the exact number, but it's north of 20. They're all kind of \$10-\$250 million, maybe a couple of ones at \$300 million. They're small enough to integrate nicely and easily. They often fill technology holes or gaps... I wouldn't rule out buying a large company if the price and opportunity were right.

On his role in the new look and feel for the headquarters lobby and cafeteria:

I was talking to [architect] Art Gensler at a social thing. He was complaining about how drab our buildings were. He said good taste doesn't cost any more. But when his guys gave me an estimate, I was like, "Whoa, Art told me good taste doesn't cost any more." So we're going to have to do some trimming.

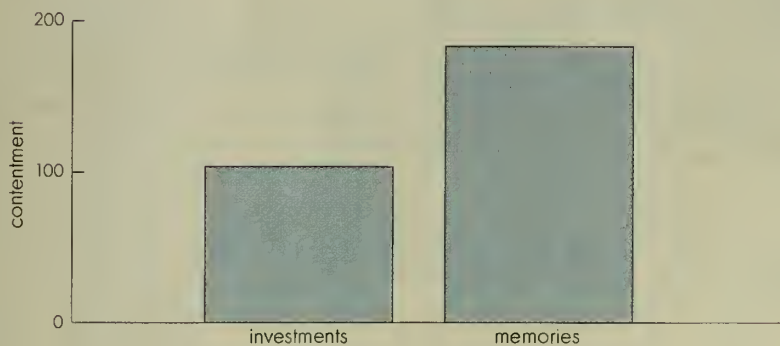
Will he have a motto, like Andy Grove's "Only the paranoid survive"?

He wrote that after he was in the job five or six years. [Laughs] Come back to me then.



CONTENTMENT INDEX

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BAJA BLISS
Compensation manager Melanie Stagnitti took eight weeks off on Intel's dime

them. Such generosity actually helps the bottom line managers insist. Giving employees a period of respite is an antidote to the world of networked, always-on careers that lead to information overload. Sabbaticals reduce turnover and retain wisdom otherwise lost when veteran employees burn out. A recent study in the *Journal of Education for Business* found that the benefits of sabbaticals outweigh the costs when a good understanding between employer and employee regarding expectations is involved. The study also found that employees return more committed and more energized. In fact, sabbaticals are so alluring that companies report that it's almost impossible for competitors to poach anyone within a few years of his bonus vacation. The absences also give

managers a chance to see how well others perform while filling in for their leave colleagues.

The number of companies offering paid sabbaticals is small but steady. A 2005 annual survey by the Society for Human Resource Management finds that 5% of corporate respondents offer the perk. Another 18% offer unpaid sabbaticals, which are increasingly being used as an alternative to layoffs when demand slackens. But there is some flux. Cracking the whip, Steve Jobs nixed Apple Computer Inc.'s program after returning as chief executive in 1997.

On the other hand, relative newcomers such as women's clothing designer Eileen Fisher Inc. have initiated sabbaticals, while McDonald's Corp., where the perk dates back more than 40 years, is expanding the benefit in 2006 to even five years. "What it's all about today is how do you differentiate yourself as a company?" says Richard Floersch, McDonald's chief human resources officer. "This gives us bragging rights."

SEVENTH HEAVEN

SABBATICALS ORIGINATED in academia. Most colleges and universities award them to professors every seven years as a time for rest and reflection, as if that milestone year were a kind of sabbath. In (page 46) maintains this tradition

Nice Work If You Can Get It

A handful of companies offer sabbaticals—and insist that they're worth the cost

BY MICHAEL ARNDT

LAST WINTER, INTEL CORP. paid Melanie Stagnitti to research and develop her tan. Fleeing the soggy dreariness of Hillsboro, Ore., the compensation and benefits manager and her stay-at-home husband, John, packed up their 5-year-old son and 3½-year-old daughter in their Ford Explorer and, towing a trailer full of camping gear, sauntered down to Mexico's sun-drenched Baja peninsula.

For eight weeks, Stagnitti was utterly unplugged. She had no access to e-mail,

voicemail, the Internet, or, for much of the time, electricity. Today she's logging 50-hour workweeks again. But all that time lounging in a hammock helped make up for the long days. "The best part," she says, "was seeing the kids outside every day, playing in the water and being free."

These days many companies view employees as profit sponges, particularly sitting-bull seniors who have received pay raises year after year. Paternalism is out; lean and mean is in. But across the economy, a stubborn minority of employers is treating workers like tenured professors, lavishing paid sabbaticals on

chedule. Under a program that began in 1991, the Santa Clara (Calif.) chipmaker grants all full-timers a paid eight-week holiday on every anniversary divisible by seven, along with their usual three to four weeks of vacation. Stitch the time together with a few paid holidays, and it's possible to be away without interruption for a quarter of the year. Some 4,350 workers, nearly one of every 20 at Intel, take sabbaticals in a given year.

Other programs kick in even sooner. Morningstar Inc., for instance, begins handing out an extra six paid weeks to full-timers at the four-year mark. Patrick Dorsey, director of stock analysis at the investment-research outfit, used his first sabbatical in 2002 to go on an around-the-world honeymoon with his new bride, Katherine. Jetting from Morningstar's headquarters in Chicago to South Africa, with a layover in London, they went on a 10-day safari, then flew to Australia for 10 days and New Zealand for two weeks. Being gone so long—Dorsey didn't communicate with the office while overseas—allowed him to really relax. "This may sound like a lousy attitude, but you come back and you're ready to rock and roll," he says.

Won't regular old vacations do? Studies have found they don't allow enough time for rest and reflection. A third of employees don't even take all their time off, with the same number reporting that they feel chronically overstressed at work, according to a recent study by the Families & Work Institute.

Despite the obvious appeal to employees, most businesses are less extravagant when it comes to observing anniversaries. In a Hewitt Associates survey, 55% of employers say they give workers a gift worth up to \$50 when they hit their 10-year date; 67% also throw them a party.

The big reason more companies don't offer sabbaticals, of course, is money: A company has to

overstaff to be able to allow employees more time off, and that's often heresy at a time when management is scrounging for ways to slash personnel expenses. Scheduling can be a headache, too, since managers have to find others to cover for every worker away on leave.

But many HR managers argue that since sabbaticals encourage people to stick around, companies don't have to spend as much on recruitment and training. Assigning temporary fill-ins can be a plus, too. While Intel's Stagnitti was in Mexico, her supervisor tested someone else in

McDonald's workers get eight weeks of paid leave for every 10 years

her job. When she came back, that employee ended up staying on, and Stagnitti was promoted to a new job in HR. In addition, the generation just entering the workforce ranks time off as a top priority in survey after survey. Thus, offering sabbaticals should help attract young talent, says Hewitt consultant Raymond Baumruk.

Probably no company has handed out more sabbaticals than McDonald's. The fast-food colossus gives every salaried employee an eight-week paid leave for every 10 years of employment, from execs at its Oak Brook (Ill.) headquarters to

managers of its company-owned restaurants in the U.S. That's thousands a year. CEO James Skinner went on sabbatical earlier in his 34-year career at McDonald's, and the company now has 40-year veterans enjoying their fourth getaway. This year, to attract and retain new employees, McDonald's is adding an in-between breather: an extra week off for every anniversary that ends in a five.

Like employees elsewhere, McDonald's loyalists often use their sabbaticals for blowout vacations. Not Janice L. Fields. The president of McDonald's central U.S. division, Fields travels three or four days every week to oversee 4,400 outlets. She spent her eight-week leave last winter with her retired husband, Doug Wilkens, at their second home in Florida.

She slept in. She worked out. She played golf. She cooked. She watched Oprah. She reconnected with her spouse. And she left town only once, to go to Cincinnati for her grandson's eighth birthday. After 27 years at Big Mac, she deserved a break. And thanks to the company's sabbatical program, she got one. ■

ON SAFARI
Morningstar's gift to the Dorseys



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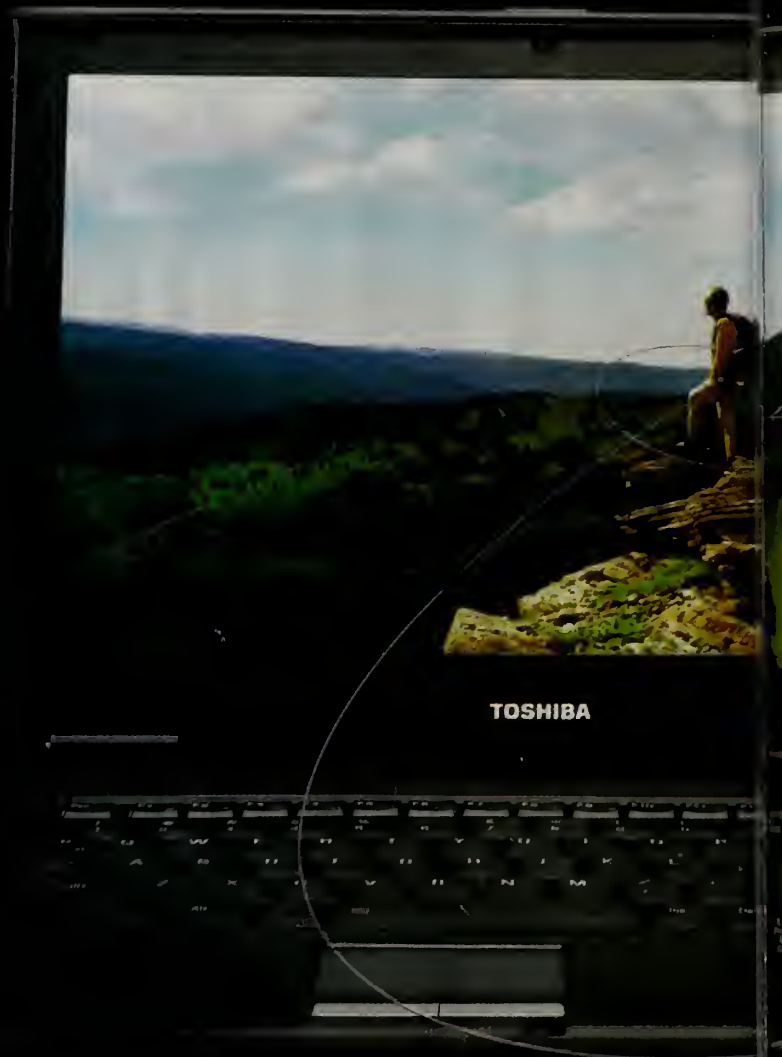
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The Patent Epidemic

It's wasting companies' money and slowing the development of new products

BY MICHAEL OREY

A man "has a right to use his knife to cut his meat, a fork to hold it; may a patentee take from him the right to combine their use on the same subject?"

—Thomas Jefferson

THE ORDER WAS POTENTIALLY a big one for KSR International Co. General Motors Corp. wanted the Canadian auto parts maker to supply gas pedals for its 2003 Chevrolet and GMC light trucks and sport-utility vehicles. But not just any pedals. GM wanted adjustable ones that could move back and forth to accommodate drivers of different heights. And it wanted the pedals to send an electronic signal, rather than using a mechanical cable, to change the engine speed when a driver stepped on or off the accelerator.

Both features had been around the automobile industry for a number of years, so KSR set about designing a combination. Not so fast, warned a March, 2001, letter from Teleflex Inc., a Limerick (Pa.) competitor that had gotten wind of KSR's discussions with GM. Teleflex claimed its patents covered all combinations of an adjustable pedal with an electronic sensor and that anyone else making them would be infringing. If KSR wanted to proceed, the letter said, it needed to pay Teleflex a royalty. Rejecting the demand, KSR sealed the deal with GM, which it still supplies.

Teleflex sued KSR, and the companies are now locked in litigation. KSR's defense is simple: U.S. law does not allow patents for inventions that are "obvious."

Nothing could be more obvious, KSR says in court filings, than a combination of "preexisting, off-the-shelf components" that each perform "exactly the same function" for which they were originally designed. In essence, KSR's argument is that Teleflex may as well have patented the combination of the refrigerator and the light bulb. Rodger D. Young, Teleflex's attorney, counters: "The fact that Device A and Device B exist does not make it...obvious that they should be put together."

HIGH COURT INTEREST

KSR HAS ASKED THE U.S. Supreme Court to weigh in. If it does, the gas pedal dispute will join a high court docket unusually rich in patent cases this term, with the collective potential for broadly reshaping current law. The justices have not taken such an interest in the area since 1965.

How to determine when an invention is "obvious" is one of the most critical and contentious issues in patent circles. Over the past two decades, critics say, the hurdle for passing the obviousness test has been steadily lowered, and the U.S. is now awash in a sea of junk patents. Some are just plain silly, such as a patent for "a method [of] exercising and entertaining cats" (basically teasing them with a laser pointer), or another for "an animal toy that a dog may carry in its mouth" (which not only sounds suspiciously like a stick but also looks like one in the patent drawings).

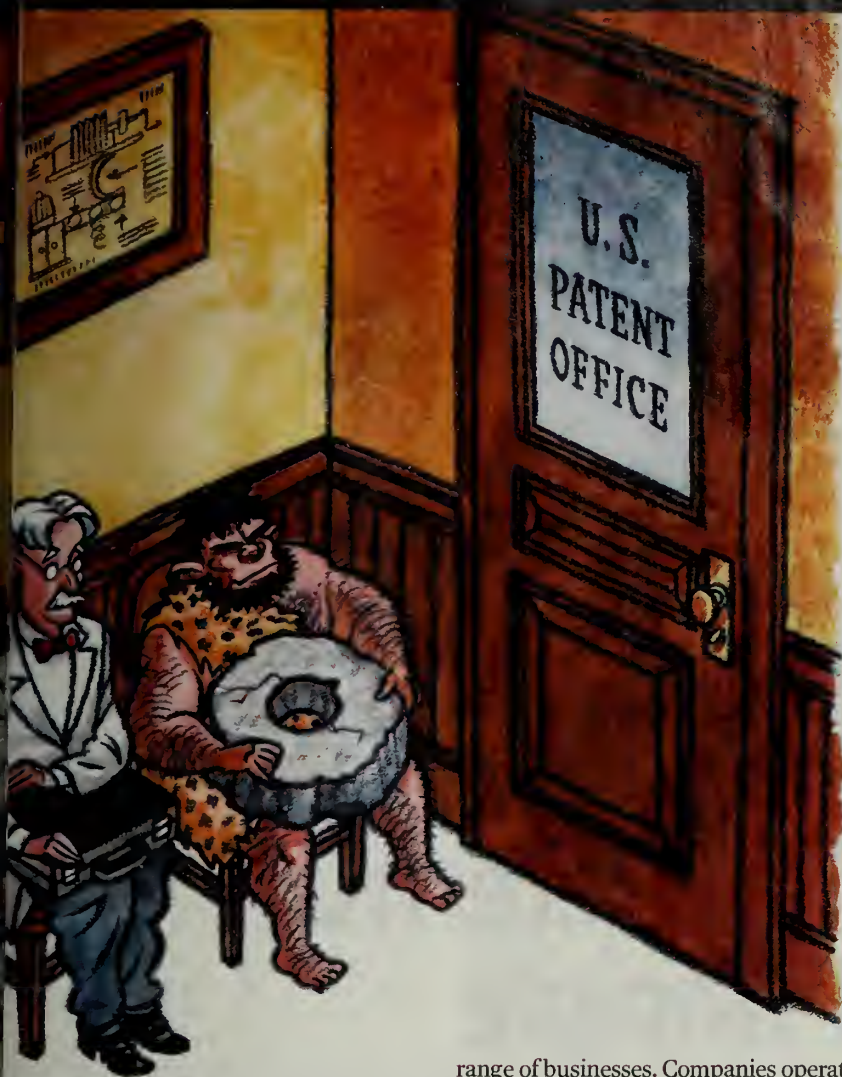
But many perceive a serious threat. A coalition of businesses, including Microsoft, Cisco Systems, VF, Hallmark Cards, and Fortune Brands has jointly filed its own brief in the KSR case asking the Supreme Court to take corrective ac-

tion. Two dozen intellectual-property law professors have made a similar filing. Massive overpatenting, the professors say, "creates an unnecessary drag on innovation," forcing companies to redesign their products, pony up license fees for technology that should be free, and even deter some research altogether.

The tide shows no sign of turning. In 2004, the U.S. Patent & Trademark Office issued 181,000 patents, up from 99,000 in 1990. New applications, meanwhile, are being filed at a rate of about 400,000 per year. If the Patent Office closed its doors today it would need two years just to clear the backlog.

One reason for this explosion is the natural tendency of patents to track broad economic and technological trends. Just as





the early 20th century saw the advent of large-scale patenting of chemicals, the past two decades have witnessed the spread of patents on computer software, business methods, and genes. Controversy often accompanies the expansion. For example, critics say many business method patents, for processes that perform operations, are often nothing more than combinations of age-old practices with a computer or the Internet.

In an article in *The National Law Journal* last month, New York attorney Barry Schindler expressed the current patent-everything-in-sight mentality. Seizing on a recent ruling by a Patent Office administrative board that said method patents don't even need to make use of technology, he advised companies to "now seek U.S. patent rights for any unique business method covering every conceivable business operation, such as methods of billing clients, hiring employees, marketing products or service...or simply obtaining funding."

All this complicates day-to-day life for a

range of businesses. Companies operating in patent-choked environments are at continual risk of tripping over someone else's intellectual property. Microsoft Corp. is now defending itself in 35 to 40 patent infringement suits simultaneously, and Cisco Systems Inc. faces seven. That in itself is a sign something is amiss, says Robert Barr, who was chief patent counsel for Cisco from January, 2000, to July, 2005.

Barr, who now teaches at the University of California at Berkeley School of Law, says it's too easy for engineers to inadvertently infringe patents just by doing their normal work. "That's not what the law is intended to do," he says. "There shouldn't be patents on things that people will just routinely invent." Barr adds that "the idea of the obviousness test is to root these things out."

Old Economy companies face similar trouble. Apparel maker VF Corp., for instance, regularly gets letters complaining it has infringed bra patents. "In the old

days you would think of these things as the tinkering of a technician who knew his way around women's apparel...and wouldn't even think about getting a patent on it," says Peter Sullivan, the attorney who filed the brief in the KSR case on behalf of VF and others. "How many bra patents can you possibly have?"

Defeating even a dubious patent can take tremendous resources. After Storage Technology Corp. sued Cisco for patent infringement, it took Cisco six years and \$10 million to get a jury to declare last June that StorageTek's patent was invalid. (StorageTek was purchased by Sun Microsystems Inc. a week before the verdict.) Even before the trial, Cisco believed the disputed technology was obsolete and no longer used by its customers. But it still had its engineers remove it from its routers because of the potential for draconian damages or an injunction if Cisco had lost.

DEFENSIVE PATENTING

THOSE KINDS OF litigation-driven business decisions can waste resources and money. So can another strategy known as defensive patenting. To ward off claims of infringement from others, companies pump up their own patent portfolios. Cisco has gone from obtaining a few hundred patents annually to around 1,000. "A large part of that investment is to assure that if someone wants to assert patents against us, we will have some countervailing tools," says Cisco General Counsel Mark Chandler.

It's the patent world's equivalent of mutually assured destruction. Instead of suing, companies agree to license each other their intellectual property. "A network router, a golf club, a software program...a bra all become more expensive as more and more patent holders must be paid royalties," notes the brief filed in the KSR case by Cisco and others.

To many observers, one of the primary culprits in this situation is the evisceration of the obviousness test by the Federal Circuit Court of Appeals. That has led to a flood of low-quality patents being granted, and made it particularly difficult to challenge a

patent in court on the ground of obviousness. In 2001, Microsoft settled a suit by Priceline.com for infringing its "name-your-price" auction patent. Yet to this day, Andy Culbert, Microsoft's top in-house patent litigation counsel, says the Price-

**Defeating
a dubious
patent can
take years
and cost
millions**

line patent is a prime example of an obvious combination of two things that already existed: reverse auctions and the Internet.

KSR initially was able to persuade a court that Teleflex's invention was obvious. After Teleflex filed suit in federal court in Detroit, Judge Lawrence P. Zatkoff considered evidence from engineering experts on whether combining an adjustable pedal with an electronic sensor would have been obvious to someone having skill in the area. He concluded that it would and ruled on summary judgment in December, 2003, that Teleflex' patent was invalid. (Teleflex sold its pedal unit to a private-equity group last August. It now operates in Troy, Mich., under the name DriveSol Worldwide Inc.)

But in January, 2005, the Federal Circuit Court of Appeals vacated Judge Zatkoff's ruling. The court, which hears nearly all patent appeals, said the judge had not followed its rule for inventions based on a combination of existing elements. That rule says courts—and patent examiners—can't reject an invention as obvious unless they can point to specific references suggesting the elements could be combined. Those references are typically previous patents or technical literature.

Defenders of the rule say it prevents hindsight bias—the natural tendency of a person to regard something as obvious once she sees it—by requiring documented evidence that an idea was easily within grasp. KSR and others who oppose the rule say it is contrary to guidelines set by the Supreme Court, which last considered the issue 40 years ago. And they say it doesn't square with how the world works.

Microsoft attorney Culbert notes that new technology emerges all the time that isn't written about in scientific journals or other published materials, particularly in fast-developing areas such as software. Other commentators have noted that, in many fields, what gets written down is precisely what isn't obvious, guaranteeing that what the Federal Circuit Court requires won't be found. The bottom line: Rulings rejecting patents on the basis of obviousness are rare, and massive overpatenting continues to be a thriving business. ■

BusinessWeek online For a look at key patent cases the Supreme Court has already decided to hear this term, go to www.businessweek.com/extras



The Peterman Principle

John O'Hurley turned his *Seinfeld* role into an unlikely but profitable investing career

BY ROBEN FARZAD

SO MUCH FOR THE SEINFELD Curse—that supposed hex that keeps the nineties sitcom's cast members from revisiting their former glory. John O'Hurley, the actor who played J. Peterman, Elaine's lovably pompous boss, has parlayed his *Seinfeld* fame into a thriving, multifaceted career. In the past few months, he appeared in ABC's summertime hit *Dancing with the Stars*, landed a classical CD that included his keyboard composition on the *Billboard* charts, and signed on to appear in January as Billy Flynn in the Broadway production of *Chicago*. *People* magazine in November named him one of the sexiest men alive.

And that's just the show-biz stuff. Un-

knownst to most of his fans, O'Hurley has enjoyed parallel success as an investor and financier—also built on the Peterman character. The 51-year-old sits on the board of the real J. Peterman Co. and owns a sizable stake. He is a principal partner for Round One Investments in Los Angeles and Heritage Capital Advisors in Atlanta, two private-equity outfits. He also holds a big chunk of a restaurant chain and is an owner of Alaskan airline Era Aviation.

PRIVATE FINANCES

"I CONSIDER myself a corporation with several divisions," he says, sitting in the well-appointed living room of his 1920s-era Beverly Hills mansion, which he shares with his new wife Lisa and two dogs. He declined to give specifics about

SAVVY INVESTOR

O'Hurley is a partner in two private-equity firms

his investments, since they are mostly private.

O'Hurley could easily live on his *Seinfeld* syndication royalties. But after years as a work-a-day actor, it's hard for him to turn down gigs, even now. Peterman-as-pitchman alone, he admits, is worth seven figures a year. The character, he says, "is that Mr. Magoo-type buffoon who can say anything for corporations."

After graduating from Providence College in Rhode Island

with a theater degree in 1976, O'Hurley took stock of his financial future. "I knew how to act," he says, "but I didn't know how to make a living out of it." So for five years he deferred his dream and worked in public relations, where he was able to squirrel away some money. "I was miserable. But I learned that the business comes first, then the show."

O'Hurley moved to New York in 1981 to pursue acting and eventually made a nice but unremarkable living on stage and as a soap opera mainstay. Then came the casting call for the Peterman character in 1995, six years after *Seinfeld* debuted. At the audition, O'Hurley was handed a J. Peterman catalog and asked to create the voice behind the product descriptions. "I thought of a '40s radio host mixed with Charles Kuralt," he says. Out came the melodramatic baritone that would become one of the show's trademarks. ("I'm afraid it's your urine, Elaine. You've tested positive for opium. That's right. White Lotus. Yam-yam. Shanghai Sally.")

So popular was the character that, in 2001, the actual John Peterman, whose company ended up in bankruptcy after overexpanding, approached O'Hurley with an invitation to invest in the real thing. Says O'Hurley: "He and I would walk together in Manhattan and every other person would stop me and say, 'Hey, Peterman!'" The character, O'Hurley calculated, gave the real J. Peterman Co. around \$825 million worth of NBC publicity over

the years. As a board member and investor, O'Hurley focused on improving the brand's Internet and licensing strategies, both of which have paid off: The company is now turning a profit and once again expanding, carefully this time.

MORE THAN A PRETTY FACE

THE PETERMAN character has figured prominently in O'Hurley's other business ventures, too. John Robison, founder of Round One Investments, was sipping cocktails at a Santa Monica (Calif.) bar one night in 1998 when, he says, "I heard the Peterman voice behind me." Robison struck up a conversation and before the night was over called O'Hurley an "ad whore"—to which, according to Robison, the actor deadpanned, "I prefer 'commercial concubine.'"

The two discussed the major holding at Round One, an online video-technology company that needed a spokesman. O'Hurley agreed, with the understanding that he be given a hands-on role at the investment firm. Now, he's a principal partner and has an equity stake in the shop. O'Hurley has returned the favor, bringing on Robison to invest with him in cafeteria chain Piccadilly Restaurants, of which he and a group of private investors own 40%. "He's not just another pretty-faced actor," says Robison. "He has a commanding business sense."

In 1997, a partner at Heritage Capital Advisors met O'Hurley at a golf benefit, and the two chatted about the stock of Shop At Home, a struggling television-shopping channel whose shares, O'Hurley figured, could benefit from a strategic shake-up. "I said I wasn't happy with it

lying so flat," he recalls. "So why don't we buy the entire company?" John Ray, Heritage's president, says O'Hurley made a compelling case that the stock was trading at less than its asset value.

So Heritage, with O'Hurley on board, made a \$5 million investment and, at his prodding, "rabble-raised" for operational changes. In 2002, Scripps bought a controlling stake, allowing Heritage to sell its position at more than triple its investment. Heritage then used the proceeds to snap up five struggling gospel and country radio stations in the South. On an O'Hurley hunch that the growing Dixie Hispanic market was underserved, Heritage converted them into Spanish-language stations and quickly sold two at a nice profit; the remaining three are now drawing substantial interest from big media players, says Ray. (O'Hurley will only smack his lips when queried about their asking price.)

The actor sees his investing exploits as validation that he's more than a well-coiffed talking head. "They approach me as a spokesman," he says, of the investment firms that keep offering him various opportunities. "But I want equity and a say in the partnership."

Now the actor-financier is preparing to circle back to the Manhattan theater scene to star in the musical *Chicago*—equipped with both business smarts and some extra pocket money. "Not every actor is going to make \$20 million a picture," he says, putting aside the Peterman persona for a moment to share his career's lesson. "But there are still ways to use money to own things, so that you're not just a gun for hire." ■

BIO

A Prime-Time Portfolio

John O'Hurley has used his *Seinfeld* celebrity to build a thriving entertainment and business career.

BORN Oct. 9, 1954, Kittery, Maine.

EDUCATION BA drama, Providence College, 1976.

FAMILY Married to former Golf Channel executive Lisa Mesloh, his second wife.

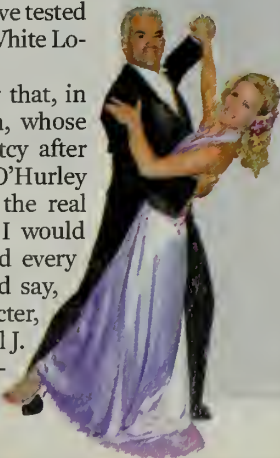
BUSINESS Part owner of the J. Peterman Co.; principal partner at Heritage Capital Advisors in Atlanta and Round One Investments in Los Angeles; major investor in cafeteria chain Piccadilly Restaurants, Alaskan airline Era Aviation.

TELEVISION Trained seven hours a day, six days a week for *Dancing with the Stars*. Lost to soap star Kelly Monaco, but won a fan-demanded rematch.

VOICE APPEARANCES *SpongeBob SquarePants*, *Duck Dodgers*, *Kim Possible*, *Family Guy*.

PITCH WORK Progressive Insurance, Xerox, the Travel Channel.

RECORDINGS *Peace of Our Minds*, with cellist Marston, debuted at No. 13 on the Billboard classical chart.



Bucking the Odds At Amylin

With Ginger Graham at the helm, the company has two approved diabetes drugs

BY ARLENE WEINTRAUB

AT LEAST ONCE a day, Ginger L. Graham follows a routine that many people with diabetes know all too well: She pricks her finger and tests her blood sugar. Graham, chief executive of Amylin Pharmaceuticals Inc., does not have diabetes. But her company just launched two new drugs to treat the disease, and Graham believes that to truly understand her customers, she must live the diabetic lifestyle. "I just think we don't appreciate how hard their lives are," she says. So she watches her diet, taking notice of foods that can cause dangerous glucose swings. But it's the finger sticks that are the toughest to get used to. "I dread it," confesses Graham, 50. "It's so unpleasant."

Those daily jabs are pretty much the only pain Graham is experiencing these days. In the spring, after 18 years of regulatory setbacks and near-death experiences, San Diego-based Amylin pulled off a rare feat in biotech, scoring Food & Drug Administration approval for both its first and second products. The back-to-back wins—which Graham celebrated by jumping into the fountain outside Amylin's headquarters—instantly transformed the company from a pure research outfit to a player in the pharma business. And Graham, who has been CEO since 2003, found herself facing brand new challenges, from cobbling together a salesforce to gearing up for commercial



GRAHAM The former Lilly exec was mulling retirement before Amylin

manufacturing. "We needed to hire 300 people all at once," she says.

For the most part, Amylin's transition is going swimmingly. In March the company introduced Symlin, an engineered form of a human hormone that insulin-dependent diabetics can take along with insulin to smooth out dangerous fluctua-

tions in blood sugar. Two months later, Amylin launched Byetta, a drug derived from a hormone found in the saliva of desert-dwelling Gila monsters. The injected hormone, aimed at diabetics who are not yet dependent on insulin, helps them control their blood sugar. That, in turn, could keep patients from sliding toward insulin dependency. The company is on track to report 2005 sales of \$122 million, analysts estimate. Because of its frantic expansion, Amylin's loss is expected to jump 38% over 2004, to about \$216 million. But analysts believe the company could turn profitable by 2008 and surpass \$1 billion in annual sales the following year.

Graham already has her scientists working on an improved version of Byetta, which may have to be injected only once a week, as opposed to twice a day. And the drug may offer an additional benefit: In August the company announced that in an early clinical trial, patients taking the longer-acting drug lost an average of nine pounds.

Considering that most diabetes treatments cause patients to gain weight—which in turn aggravates their condition—investors were stunned. "I don't think anyone has seen such compelling data," says Kris H. Jenner, a biotech analyst for T. Rowe Price Group Inc., which holds shares of Amylin. Hopes for the next generation of Byetta, which could be introduced by 2008, helped push Amylin's stock up 58% in 2005, to \$39.70.

DIRE STRAITS

THERE WAS A time when Amylin's fate seemed as precarious as that of the threatened Gila monster. In 1998, Graham was an executive at device maker Guidant Corp. and serving on Amylin's board when the

company suffered some setbacks. Johnson & Johnson pulled out of a key research partnership, Amylin's share price fell to 31¢, and it was nearly delisted from the NASDAQ. Six weeks from running out of cash, the biotech stripped down from 300 employees to 37.

Amylin was in such dire straits that



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some board members invested their own money to keep it afloat. Graham contributed \$200,000 to the cause. "I thought: 'This is somebody who puts her money where her mouth is,'" says Chief Operating Officer Daniel M. Bradbury. The company raised \$33.5 million altogether, allowing it to continue studying its flagship drug Symlin, as well as Byetta, which Amylin acquired from its inventor in 1996.

SLEEPING BEAUTY

IN 2003, GRAHAM was mulling early retirement when Amylin's board asked her to take over as CEO. She quickly abandoned the idea of spending her days riding horses and learning to play the harp her husband bought her as a retirement gift. But shortly into her tenure, Graham realized the job might be harder than she anticipated. Unexpectedly, the FDA said it

multaneously mourning the death of her mother. In a pep talk to the staff, Graham explained that Symlin was like Sleeping Beauty: "She was still beautiful, but she had to go to sleep." After Symlin was approved, Graham came to work dressed as the newly awakened Sleeping Beauty and handed out hardbound copies of the fairy tale.

Graham has always had a penchant for the theatrical. As a child growing up on a chicken farm in Arkansas, she competed in local rodeos, earning the title of Arkansas High School Rodeo Queen. "I could rope a calf or tie a goat or run barrels and poles," she says. As an undergraduate at the University of Arkansas

Graham must remake Amylin into a sales-driven company

her manager to demand that the previous sales rep—a man—return to the account. Her manager refused, and an undaunted Graham kept calling on the customer. "I hung out there, I got to know all the staff," she says. Her stubbornness paid off. He became a loyal customer.

The normally soft-spoken and approachable Graham can turn crusty if she's not

getting her way. After returning to Lilly in 1986, Graham worked in a variety of divisions, ranging from finance to pharmaceuticals to medical devices. In 1987 she managed the sale of Elizabeth Arden to Fabergé for \$735 million—then the largest cosmetics deal ever. When one of the Morgan Stanley bankers dragged his feet, "she had him backed into a corner and she was screaming at him," says Michael Hunt, who worked with her on the deal. "She was holding him accountable." In the middle of the negotiations, the Black Monday market crash forced the parties to restructure the financing. Still, Graham and Hunt managed to close it at the originally agreed-upon price.

Today, Graham is facing a delicate balancing act. She has to transform Amylin into a sales-driven company without letting go of the scrappy culture that inspired those original 37 survivors to stick by two promising drugs. "How do you infuse that into all these new people who didn't go through the Valley of Death?" asks Joseph C. Cook Jr., Amylin's former CEO and now chairman of the board. "Ginger worries about that." Graham vows to continue to spend heavily on research, nurturing Amylin's experimental drugs to treat obesity and heart failure. And she spends much of her time on the road, speaking to all of the newly hired salespeople.

The rodeo-queen-turned-CEO revels in telling new recruits about Amylin's two-decade fight for survival. One of her favorite stories describes an early Amylin investor who was so determined to nurture new treatments for his diabetic daughter that he FedExed a \$6.2 million personal check to the company. Graham refers to these specimens of corporate lore as "cave paintings," and at her San Diego office she surrounds herself with symbols of Amylin's history, including figurines of Gila monsters and her personal copy of *Sleeping Beauty*. Every day they remind her of the challenge she has taken on. "I need to transfer what was," she says, "to what we're about to become." ■

BIO

Ginger L. Graham

Throughout her life, Graham has demonstrated a theatrical flair and a persistence in the face of tough challenges



BORN Nov. 18, 1955, in Springdale, Ark.

POSITION CEO of Amylin Pharmaceuticals, which recently launched two drugs to treat diabetes.

EDUCATION BS in Agricultural Economics, University of Arkansas, 1979; MBA, Harvard, 1986.

FIRST JOB Arkansas State Rodeo Queen.

HOW BEING A FARMGIRL PREPARED HER TO BE

CEO: "We had to grow what we ate, and we took care of animals that were dependent on us. I learned

pretty quickly that there are things bigger than me—the seasons, life and death, and disappointments. As a kid, that teaches you to work hard and be resourceful."

BIGGEST DEAL As an executive at Eli Lilly & Co., she brokered the 1987 sale of its Elizabeth Arden unit to Fabergé for \$735 million—then the largest sale ever of a cosmetics company.

FAMILY Married to insurance executive John since 1998, three grown stepchildren.

wouldn't approve Symlin without more clinical trial data.

It was the second such request—and a chilling warning that the drug might never see the light of day. On the other hand, early studies of Byetta indicated that it might be a billion-dollar drug. Graham deliberated briefly before shifting all but 20 of the 350 employees then working at Amylin over to the Byetta team.

For the many employees who had staked their careers on Symlin, the move was painful. The mood at Amylin was grim, especially for Graham, who was si-

she won the 1976 state title and then competed at the national Miss Rodeo America Pageant. Her speech about Arkansas garnered her the top prize in the public-speaking portion of the contest.

Competing in the male-dominated world of rodeo prepared Graham well for her first corporate gig, selling agricultural chemicals for a division of Eli Lilly & Co. As a woman working in agriculture at that time, Graham was such an oddity that her very presence offended some customers. One of Lilly's largest buyers refused to work with Graham and called



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INVESTIGATIVE REPORT



GOLD RUSH

Online payment systems like e-gold Ltd. are becoming the currency of choice for cybercrooks

BY BRIAN GROW

PRIME COURSES THROUGH THE INTERNET in ever-expanding variety. Hackers brazenly hawk stolen bank and credit-card information. Pornographers peddle pictures of little boys and girls. Money launderers make illicit cash disappear in a maze of online accounts. Diverse as they are, many of these cybercriminals have something important in common: e-gold Ltd.

E-gold is a "digital currency." Opening an account at www.e-gold.com takes only a few clicks of a mouse. Customers can use a false name if they like because no one checks. With a credit card or wire transfer, a user buys units of e-gold. Those units can then be transferred with a few more clicks to anyone else with an e-gold account. For the recipient, cashing out—changing e-gold back to regular money—is just as convenient and often just as anonymous.

E-gold appeals to "gold bugs": people who invest in the precious metal and believe money ought to be anchored to it. E-gold boasts that its digital currency is backed by a stash of gold bars stored in London and Dubai. But e-gold also appeals to savvy online crooks who want to move money quickly and without detection. American banks and conventional cash transmitters like Western Union are legally required to monitor customers and report suspicious transactions to the government. E-gold seems to go out of its way to avoid such obligations. Its operations are in Florida, but in 2000, its principals registered

the company in the lightly regulated Caribbean haven of Nevis.

Law enforcement officials worry that the little-known digital currency industry is becoming the money laundering machine of choice for cybercriminals. On the evening of Dec. 19, agents with the Federal Bureau of Investigation and Secret Service raided the Melbourne (Fla.) office of e-gold's parent company, Gold & Silver Reserve Inc., and the nearby home of its founder, Douglas L. Jackson. Agents copied documents and computer files, but so far no charges have been brought. The Secret Service and the FBI declined to comment on the raid. Jackson has denied any wrongdoing, though the raid isn't the first indication that federal investigators view e-gold as a magnet for online misdeeds. The FBI separately is pursuing about a dozen probes in which e-gold appears as a "common denominator," a senior agent says.

The potential danger goes beyond e-gold. Investigators say other digital currencies are similarly used for corrupt purposes. All told, there are at least a dozen such services worldwide, based in places like Russia and Panama. Eight of them, including e-gold, claim to be backed by actual bullion. As a group, these firms do billions of dollars a year in transactions, according to Jim Davidson, a spokesman for the Global Digital Currency Assn. in New York. E-gold and its rivals make money by charging small percentage fees on those transactions.

Most of the law enforcement interest in e-gold involves al-

leged fraud and money laundering by its users. A tour of some outlaw corners of the Internet illustrates why. One Web site called CC-cards—where cyberthieves sell pilfered bank account and credit-card information—often asks for payment via e-gold. Some sites pushing child pornography have dropped Visa and MasterCard recently in favor of e-gold, according to the National Center for Missing & Exploited Children, which tracks underage porn.

But U.S. officials have another concern: that e-gold and rival digital currencies could be used to finance terrorism. It's a notion the companies all reject.

SUBPOENA CENTRAL

THE MAN BEHIND E-GOLD, Doug Jackson, is a tall, powerfully built former oncologist. A fan of the gold standard, Jackson, 49, became a pioneer in digital currency when he set out a decade ago to create what he describes as a private gold-based monetary system. He envisioned e-gold as a currency that would be accepted at Wal-Mart while also permitting peasants from China to Peru to offer products at stable prices. "I thought there would be this flock of e-gold users, and I would be their messiah," he says. "It just didn't happen."

What did happen, according to law enforcement officials, was that a pack of felons flocked to Jackson's brainchild. Sitting in an undecorated conference room in the Melbourne office three months before the federal raid, he acknowledged that he had a "six-inch pile" of subpoenas from such agencies as the FBI, the Securities & Exchange Commission, and the U.S. Postal Inspection Service—all seeking information about some of his more suspect customers. Investigators say Jackson may have begun his quirky business with innocent intentions. But in recent years he has turned a blind eye, the officials say, to mounting evidence that e-gold has attracted a seamy clientele. The federal raid suggests that agents are intensifying their focus on e-gold and its potential criminal liability.

Jackson didn't respond to messages after the raid. But earlier, he denied vehemently that he has looked away from crime. He said he responds as quickly as possible to official inquiries. He acknowledged, though, that his staff of 15 includes only one in-house investigator who struggles to keep up with all those subpoenas. E-gold has about 1.2 million

E-Gold's Stash

The company says its digital currency is backed by actual gold:

WEIGHT
111,376
Ounces

VALUE
\$58
Million

LOCATION
Secure facilities in London and Dubai

Data: e-gold

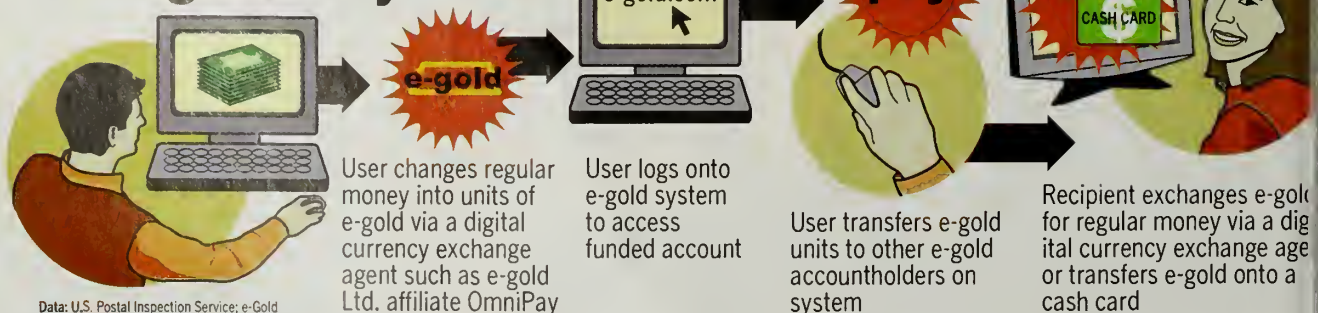
funded accounts through which transactions worth \$1.5 billion were conducted in 2005, he says. As for the idea that he should systematically monitor customer identities and money flows, he argues that's not his job: "We don't validate because we're unlike any other system."

Federal officials reluctantly confirm this loophole: E-gold and other digital currencies don't neatly fit the definition of financial institutions covered by existing self-monitoring rules established under the Bank Secrecy Act and USA Patriot Act. "It's not like it's regulated by someone else; it's not regulated," says Mark Rasch, senior vice-president of the Internet security firm Solutionary Inc. and former head of the Justice Dept.'s computer crime unit. The Treasury Dept.'s Financial Crimes Enforcement Network (FinCEN) is studying ways to close the regulatory gap. Meanwhile, U.S. officials say e-gold and similar companies should voluntarily do more to deter crime.

Started in 1996, e-gold was part of an early wave of Internet payment systems that converted conventional money into a Web currency. Most of those pioneers soon flopped, because consumers resisted paying fees to get Web cash. Others, such as PayPal, now a unit of online auction giant eBay Inc., evolved into credit-card processing services.

E-gold and a handful of rivals, including one called GoldMoney, were different. Their founders believed that tying monetary exchange to a strict gold standard would achieve greater economic stability. The Internet provided a ready venue for gold bugs the same way that it offered a soapbox to adherents of every other strain of thought. Jackson, an Army veteran and a graduate of Pennsylvania State University's medical school, was practicing oncology in Melbourne in the mid-1990s when he began reading about libertarianism and monetary theory. The married father of two adopted boys began to change his thi-

Moving Money The E-gold Way





ng. He scoured the works of libertarian novelist and philosopher Ayn Rand and was impressed by economist Friedrich A. Hayek's *The Road to Serfdom*, an influential 1944 condemnation of government control of the economy. "It looked like a lot of the suffering of recent centuries—some of the scale of wars, some of the economic dislocations—could be traced back to credit cycles. And credit cycles could be traced back to monetary manipulation" by governments, Jackson says. "I was very moved by it."

INTELLECTUAL CONVERSION

GOLD, HE CONCLUDED, WAS THE CURE. The U.S. stopped tying the dollar to a fixed amount of gold in 1971. But Jackson and a friend, attorney Barry K. Downey, decided to start what amounted to their own gold-backed currency. Jackson liquidated retirement accounts and sold his medical practice to help raise an initial \$900,000. A former colleague noticed him working on computer code around the clock at his stand-up doctor's desk. He often forgot to eat and lost weight. Along the way, he stopped attending church. Jackson confirms all this but stresses that he continued to provide excellent care for his patients until he bowed out of medicine completely in 1998.

In a series of interviews with Jackson, his statements about

e-gold swing from grandiose to resigned. "We want e-gold to be recognized as a privately issued currency and to be treated as a foreign currency" by the U.S. and other governments, he says at one point. But e-gold's offices don't conjure up images of a grand central bank. Jackson, who during one interview wore neatly pressed slacks and a yellow-striped shirt, runs his currency from a Spartan suite on the third floor of a Bank of America building.

Online currencies are patronized by software companies and other small businesses. Jackson says that the fees he charges customers—for converting real money to e-gold, administering accounts, and doing transfers—generated about \$2 million in revenue in 2005 for e-gold's parent company, Gold & Silver Reserve, which he also controls. The operation turns a profit, he adds, but he won't say how much.

Mark Jiftovic considers himself a big fan of digital currencies—but one now skeptical about e-gold. The founder of easyDNS Technologies Inc., an Internet domain name registrar in Toronto, he started accepting e-gold as payment in 2003. Jiftovic believes that digital currencies will minimize the harm of government-induced inflation. But in early 2005, investigators from the Royal Canadian Mounted Police visited easyDNS seeking information about cybercriminals allegedly using the registrar's services. It turned out that some of the suspects had paid Jiftovic's company via e-gold, he says. Angered by the police scrutiny, Jiftovic now plans

JACKSON He denies looking the other way—but admits his in-house investigator is overwhelmed

to offer rival digital currency GoldMoney in addition to e-gold. "I like the digital currency and e-gold economy, and I want to support it," he says. "But you have to run a cleaner shop than this."

The RCMP didn't respond to requests for comment. Jackson says he wasn't aware of Jiftovic's concerns or the RCMP investigation. He says that e-gold responds as quickly as possible to inquiries from law enforcement agencies and readily provides them with user names, account numbers, and transaction histories.

A number of gold buffs and some law enforcement officials see GoldMoney as a reputable alternative in the digital currency field. Based in the British Channel island of Jersey, GoldMoney is run by James Turk, a precious metals trader and former Chase Manhattan banker. He says that his company requires new customers to mail in copies of identity documents and then checks the data against lists of suspected terrorists and money launderers. The accounting giant Deloitte & Touche annually audits its gold holdings and security measures.

E-gold's Jackson says those steps are expensive and unnecessary. OmniPay, an affiliate of e-gold, is one of more than a dozen "digital currency exchange agents" that handle the conversion of conventional currency into e-gold. Jackson says that to authenticate users' identities, OmniPay sends them a special code via e-mail and conventional mail. But users aren't required to prove their identity, so it isn't clear what this accomplishes. Jackson says that his lone in-house investigator looks

Golden Touch

Here are online crimes for which e-gold allegedly has been used as a payment system:

Data: Cyota, i-DEFENSE, National Center for Missing and Exploited Children, Association of Sites Advocating Child Protection, Securities & Exchange Commission, Financial Crimes Enforcement Network, U.S. Treasury Dept., e-gold

IDENTITY THEFT & FINANCIAL FRAUD

Thieves hawking stolen bank account and credit card data frequently ask for payment in e-gold to ensure anonymity. Web sites where this has happened include CC-cards.net, dumpsmarket.com, and shadowcrew.com.

CHILD PORNOGRAPHY

Some Web sites selling access to illicit photos of boys and girls accept e-gold to hide users' payment trail from law enforcement officials. One child porn site in Russia offers access to 3,000 videos and 100,000 explicit photos, with payment via e-gold.

PONZI SCHEMES

Investment scams that purport to offer huge returns sometimes use e-gold to move money from account to account. A Ponzi scheme called E-Biz Ventures, shut down by the SEC in 2001, used more than 25,000 e-gold accounts.

MONEY LAUNDERING

Criminals use e-gold to hide money—and to transfer funds to offshore bank accounts. E-gold was used by a cybergang to transfer money into a Latvian bank that the U.S. has called a "money laundering concern."

for obvious fraud, such as a customer using "China" as his only address.

Some of e-gold's customers have been unsavory. Omar Dhanani used e-gold to launder money for the ShadowCrew, a cybercrime gang with 4,000 members worldwide, according to an October, 2004, affidavit by a Secret Service agent. Based in a stucco house in Fountain Valley, Calif., Dhanani used his PC to hide the money trail from the sale of thousands of stolen identities, bank accounts, and credit-card numbers, the government said. Accomplices sent him Western Union money orders, which, for a fee, he filtered through e-gold accounts. On Oct. 4, 2004, Dhanani, 22, who used the nickname Voleur—French for thief—boasted in a chat room that he moved between \$40,000 and \$100,000 a week. He pled guilty in November to conspiracy to commit fraud and faces up to five years in prison.

"GOOD FENCES"

E-GOLD'S JACKSON says the company was never contacted by the Secret Service regarding Dhanani and had no duty to sniff him out. E-gold's outside attorney, Mitchell S. Fuerst, calls statements in the Secret Service affidavit alleging that e-gold was used to facilitate illegal activity "nonsense." Fuerst argues that the responsibility for policing the identity and activities of e-gold account holders lies with the banks and other regulated institutions from which money is transferred into e-gold's system. Jackson goes further, insisting it's impossible to launder money through e-gold—a contention that law enforcers say is contradicted by the Dhanani case and others.

Jackson has made no secret of his desire to avoid U.S. government scrutiny. In 2000, he and his partner Downey registered e-gold Ltd. in Nevis, hoping the maneuver would add another layer of insulation from U.S. regulation. Jackson concedes that e-gold has existed in Nevis only as "a piece of paper." Its parent administers e-gold services from the Melbourne office; the operation's computer servers are in Orlando. Jackson says he chose the tiny island because registration there is inexpensive, and the government follows well-established British commercial law. Nevis is also known for lax financial regulation.

Referring to his desire to create legal distance from U.S. officials, Jackson says: "There's an element of good fences making good neighbors."

On Dec. 5, two weeks before the federal raid in Melbourne, the Nevis Financial Services Regulation & Supervision Dept. posted a notice on its Web site that e-gold had disseminated "misleading information" about its legal status. Nevis officials say that the company was removed from the island's corporate registry in July, 2003, for failure to pay the annual registration fee of \$220. Jackson didn't respond to questions about this.

Back in the U.S., e-gold has tried to shield itself semantically, avoiding basic banking terms such as "deposit" and "withdrawal" that could increase its risk of being categorized as a regulated financial institution. E-gold calls such transactions "in-exchange" and "out-exchange." Jackson says: "It's not a desire to be tricky. It's a desire to be accurate. It's important not to be misconstrued as a bank."

Whatever its legal status, e-gold's usefulness to scam artists was colorfully illustrated by E-Biz Ventures, which allegedly portrayed itself as a Christian-influenced organization that offered investors returns as high as 100%. E-Biz proprietor, Donald A. English of Midwest City, Okla., allegedly highlighted his reliance on e-gold to appeal to victims' fear of the federal government and their desire for anonymity. E-Biz investors opened e-gold accounts and transferred funds to accounts controlled by English. He shifted e-gold among more than 25,000 accounts, using new investors' money to pay some older ones. The scam took \$50 million before the SEC shut it down in 2001. Investors lost \$8.8 million. Later prosecuted in federal court in Oklahoma City, English pled guilty to wire fraud and in May was sentenced to five years in prison.

DHANANI He used e-gold to launder money for his cybercrime gang



Jackson says that when subpoenaed by the SEC in the case of the E-Biz case, e-gold supplied transaction data. A Jackson aide worked closely with investigators in the civil case. "They responded timely to every request for assistance," says Chris Condren, E-Biz' court-appointed receiver.

Evidence of e-gold's suspect following is found on numerous



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Web sites. A contributor to Cannabis Edge, a site for marijuana growers, has provided advice on how to employ e-gold and two other digital currencies—WebMoney and NetPay—to hide illicit proceeds “beyond the reach of U.S. pigs.” E-gold in particular “has strong security,” is “easy to use, and is anonymous,” said the writer, who used the name Bill Shakespeare. (Moscow-based WebMoney and NetPay, which is based in Panama City, Panama, both deny any wrongdoing.)

In addition to its abundant offerings of stolen financial data—with payment frequently sought via e-gold—the site CC-cards carried a message in November from a hacker using the name HellStorm. He advertised that for a 5% fee, he would set up and fund e-gold accounts for those who are in a hurry to do business and want to shield their identity. Users of CC-cards can make donations for the upkeep of the site by clicking on a link

that connects to an e-gold account. (E-mails seeking comment from CC-cards and Cannabis Edge weren’t answered.)

Jackson says that he wasn’t aware that e-gold was being recommended or used on outlaw Web sites until he was so informed by *BusinessWeek*. The company has since blocked the CC-cards donation account, he says. There is little the company can do about such situations, Jackson contends, unless law enforcement brings them to e-gold’s attention. Once informed “we can set a value limit to prevent an account from receiving further payments,” he says. “We can identify if there is a constellation of accounts controlled by the same miscreant.” Jackson adds: “If we get an appropriate court order, we can monitor and assist in a sting that freezes value.”

The danger of Web sites like CC-cards that are fueled in part by e-gold became very apparent to Kimberly S. Troyer. H

MONEY AIN'T WHAT IT USED TO BE

However the complicated tale of e-gold Ltd. plays out, it and a few of its rivals have already reached a milestone: For the first time, stand-alone digital currencies have real customers, even if some of those customers may engage in illicit activities.

That’s big news, since until recently digital money has been a failure. The idea of replacing paper money—messy and expensive—with its electronic equivalent seemed immensely logical in the mid-1990s, as the Internet took off. “Digital money is the ultimate—and inevitable—medium of exchange for an increasingly wired world,” intoned a June, 1995, Cover Story in *BusinessWeek* entitled “The Future of Money.” Congressional hearings with the same title soon followed, and Citicorp patented a proprietary version of digital cash. “I think money is about to remake itself,” former Citicorp CEO Walter B. Wriston told *Wired* magazine in 1996.

At the time, experts feared that privately issued digital money, untraceable and not controlled by central banks, would facilitate money laundering and tax evasion. They also worried that digital money, on a big enough scale, could undermine central banks’ ability to steer economies by setting monetary policy. Government officials sounded desperate to stop the threat. “We are nowhere near the issue of regulating it,” Stanley E. Morris, then the director of the Treasury Dept.’s Financial Crimes Enforcement Network, told *BusinessWeek* in 1995. “We’re one step back.”

Well, it turned out that the regulators had

plenty of time to catch up. DigiCash, the most innovative and best-publicized digital cash scheme, sought bankruptcy protection in 1998. CyberCash, a competitor, followed that route in 2001, the same year Beenz and Flooz, two rivals, closed their doors and left holders of their currencies high and dry. “Technologists thought that notes and coins

mistakes. By contrast, “we don’t have the same kind of protection in place for the new forms of payment,” says Anita Ramasastry, associate professor at the University of Washington Law School and an expert on laws governing digital money.

That’s why the apparent success of e-gold (and rivals like GoldMoney) in attracting customers is so striking. Besides the anonymity—which previous digital money systems also offered—the link with gold seems to provide enough solidity to overcome the potential dangers of putting your assets into a private currency. A gold-

based banking system, which is what e-gold really is, appeals to people who fret about inflation and exchange rate fluctuations and don’t trust the paper currencies central banks issue.

Still, even if digital currencies survive the e-gold controversy, they will never be a serious challenger to credit and debit cards. No one’s going to buy a newspaper with e-gold. The best bet for small retail purchases in the future is either a smart card, like the Octopus Card issued by Hong Kong’s mass transit system, or a payment capability built right into cell phones, like the Edy system in use in Japan. These systems, tied closely to

respectable institutions, don’t provoke the same worries as a stand-alone private currency like e-gold.

But a successful digital currency again raises the issues that regulators fretted over a decade ago, especially now that the world is far more tightly networked. The future of money is not here yet, but it may be a lot closer than you think.

—By Michael Mandel in New York

Back to the Future?

Digital currencies such as e-gold have been around for a decade, but they seem to be getting traction only now. Here are their pluses and minuses:

ADVANTAGES

- More anonymous
- Believed by some to be less exposed to inflation and exchange rate fluctuations
- Potentially cheaper cost of transactions

DOWNSIDES

- Anonymity can attract illegal activity
- Less legal protection for users than credit cards
- Lack of widespread acceptability

Data: *BusinessWeek*

would disappear,” says David G.W. Birch, a director of Consult Hyperion, a British consulting firm that runs an annual conference on digital money. “But money is a very conservative technology.”

For the past ten years, digital cash has been a solution in search of a problem. Credit cards do just fine for most online transactions, especially since consumers have good legal protection against fraud and

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identity went up for sale there last September. Among the 22 items CC-cards put on the block: her checking account number at Bank One, driver's license number, Social Security number, birth date, and mother's maiden name. The price for all that: \$30 of e-gold. Informed of the offer by *BusinessWeek* in December, Troyer, a 33-year-old accounting student at Davenport College in South Bend, Ind., is changing all of her identity documents. She believes she escaped without losing any money. But someone hijacked her e-Bay account and changed the address to one in China so that it could receive payments from the sale of iPods Troyer didn't own. "It makes me sick to my stomach," she says. Jackson says e-gold can't do much about such cases until he's formally alerted by the government.

There is one crime, however, to which Jackson has reacted more aggressively: child pornography. In August, he attended a conference in Alexandria, Va., organized by the National Center for Missing & Exploited Children. The center is trying to enlist banks and credit-card companies in a crackdown on payment schemes used by child porn Web sites. "There are fewer and fewer sites with Visa—and more and more with e-gold," says the center's chief executive, Ernest E. Allen. The center has a policy of not publicly identifying child porn sites it tracks. Jackson says he was appalled to find e-gold on the list of institutions used by the porn sites. He provided the center with instructions on how to seek e-gold records, and the group says it is pleased with e-gold's cooperation.

Daniel J. Larkin, head of the FBI's Internet Crime Com-



TROYER Her Social Security number and other vital data were offered for \$30 in e-gold

plaint Center, says that in recent years, e-gold has hidden behind a plausible-deniability fog." Now the fog may be lifting as the subpoenas pile up and federal agents begin to examine what they confiscated during their Dec. 19 raid. The Internal Revenue Service is separately auditing e-gold's parent, and Jackson says e-gold has voluntarily agreed to operate with an IRS review of procedures for preventing money laundering. The IRS declined comment.

TERROR TOOL?

BEFORE THE RECENT raid, Jackson said that responding to subpoenas and other government inquiries had been distracting and expensive, though he emphasized that e-gold isn't obliged to monitor its clients, he said that he could have paid more attention to vetting account holders were it not for the outside interruptions. He added that he plans

switch from an account-based log-in system to a user-based one to monitor customers more closely.

The worst-case scenario, so far undetected by officials, would be the use of e-gold by financiers of terrorism. Experts on terrorism funding note that digital currencies resemble a money-changing system known as hawala, which Middle Eastern terrorists have used. A customer gives money to a hawala service, which then telephones a similar service in another city or country that doles out money to a designated recipient. Many hawala outfits have been shut down since September 11, making digital currencies a logical next step, says Phil Williams, a professor of international affairs at the University of Pittsburgh and consultant to the United Nations on terrorism financing. "At some point, this is going to be used by terrorists," Williams says.

Jackson scoffs at this notion. "We are not bad guys, and the e-gold system simply does not pose an undue risk for use for terrorist purposes," he wrote in an e-mail on Jan. 20, 2006 to AUSTRAC, Australia's anti-money-laundering regulator, which was looking generally into potential terrorist use of digital currency.

But e-gold attorney Fuerst said in early December that his company quickly complied with requests in 2005 from Russian law enforcement and the FBI for records connected to a would-be terrorist in Russia. This person allegedly threatened to "blow something up," Fuerst said, unless a ransom was paid into an e-gold account. The FBI and the Russian Interior Ministry declined to comment.

This month's raid could signal serious trouble for e-gold. But cybercrime experts predict that if the company falters, its nefarious business will simply transfer to other digital currencies, especially ones based in countries that have lax law enforcement. Amir Orad, executive vice-president of cybersecurity firm Cyota, says that putting e-gold out of business "would not stop anything." ■

—With John Cady, Susann Rutledge and David Polek in New York

WEBMONEY: E-GOLD, RUSSIAN-STYLE

In the busy world of digital currencies, e-gold Ltd. has a controversial rival in Moscow called WebMoney. The Russian Internet currency company claims more than a million users in 37 countries, mostly in Russia and Ukraine. It has doubled its tally of customers each year since 1998, according to founder Andrei M. Trubitsin.

Like e-gold, WebMoney enables users to conduct transactions without a bank acting as an intermediary. Customers of the Russian firm exchange ordinary money for units of WebMoney, which can then be swiftly transferred to anyone else with an account on the system. WebMoney isn't anchored to gold.



BusinessWeek online For the full text of this story and more on digital currency, go to www.businessweek.com/extras

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A Property Market on Ice

How Deutsche Bank has chilled German real estate funds

BY JACK EWING

FOR RISK-AVERSE GERMAN retail investors, real estate funds once seemed like the perfect way to avoid the stomach-churning ups and downs of the stock market. The funds invest in bricks and mortar such as office buildings and are designed to pay a modest but steady return of 4% to 6% a year. Investors can redeem their shares at any time for a price based on the estimated value of fund holdings, but the shares aren't traded on any open market, and big price movements are rare.

Little wonder that, in the wake of the tech-stock meltdown, Germans poured billions into property funds, making them No. 3 in popularity as a vehicle for retail investors—after stocks and bonds. “I was always told it was an absolutely secure investment,” says Ingrid Naab, a Frankfurt schoolteacher who bought shares in a fund sold by Deutsche Bank’s DB Real Estate unit.

Now these brick-and-mortar investments aren't looking so solid after all. On Dec. 13, Frankfurt’s Deutsche Bank shocked the German banking world by freezing the \$7.2 billion fund. The bank made its unprecedented move after investors were spooked by Deutsche Bank’s announcement that it would conduct an unscheduled revaluation of the fund. Since that could only mean a sharp markdown of the underlying assets, investors crowded bank branches to redeem their shares. Freezing

the result of a long-simmering problem, Germany’s commercial-property market has been in a four-year slump, with rising vacancy rates and falling rents. Now the German banking world is waiting anxiously for the results of the independent valuation commissioned by Deutsche Bank of its frozen fund. The assessment is due in early February.

DOMINO EFFECT?

GERMAN BANKERS fear a major write-down may shatter fragile investor confidence, creating a domino effect. Other real estate funds heavily invested in property might also be forced to close and liquidate their assets, probably with big losses. Legally, investors carry all the risk, but

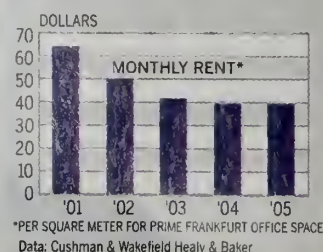
in practice German banks won't be able to avoid covering some of the loss from investments they often sell as “*mündelsicher*”—good as gold. The funds were sold almost exclusively to ordinary Germans, rather than institutional investors. “If a second one closes, then there could be a run,” says Alexandra Merz, managing director of Scope Analysis, a Berlin firm that rates investment products.

Fearful of just such a panic, regulators at Germany’s Federal Financial Supervisory Authority have ordered real estate fund managers to supply figures daily on outflows. So far, regulators say, investors have trusted the assurances from fund providers and haven't lost their nerve. Edgar Meis, a member of the executive board of the Bundesbank, Germany’s central bank, sought to calm markets by telling the business daily



FALLING INCOME

Frankfurt is emblematic of the troubled German real estate market



the fund amounts to the equivalent of a bank closing its doors to a mob of frantic depositors, and the result has been alarm in the German banking community about the reliability of the country’s \$105 billion property-fund industry.

Yet Deutsche Bank’s decision to revalue its real estate funds was

Handelsblatt in an interview published on Dec. 27 that he thinks the nation’s banks are strong enough to absorb the shock in real estate funds.

The big flaw with the funds is that they promise investors liquidity but are themselves tied up in illiquid assets such as shopping centers or industrial parks. Too many investors demand their money back, fund managers have trouble raising enough cash. The most troubled funds are generally those most exposed to the German real estate market. The Deutsche Bank fund currently on ice has some 6

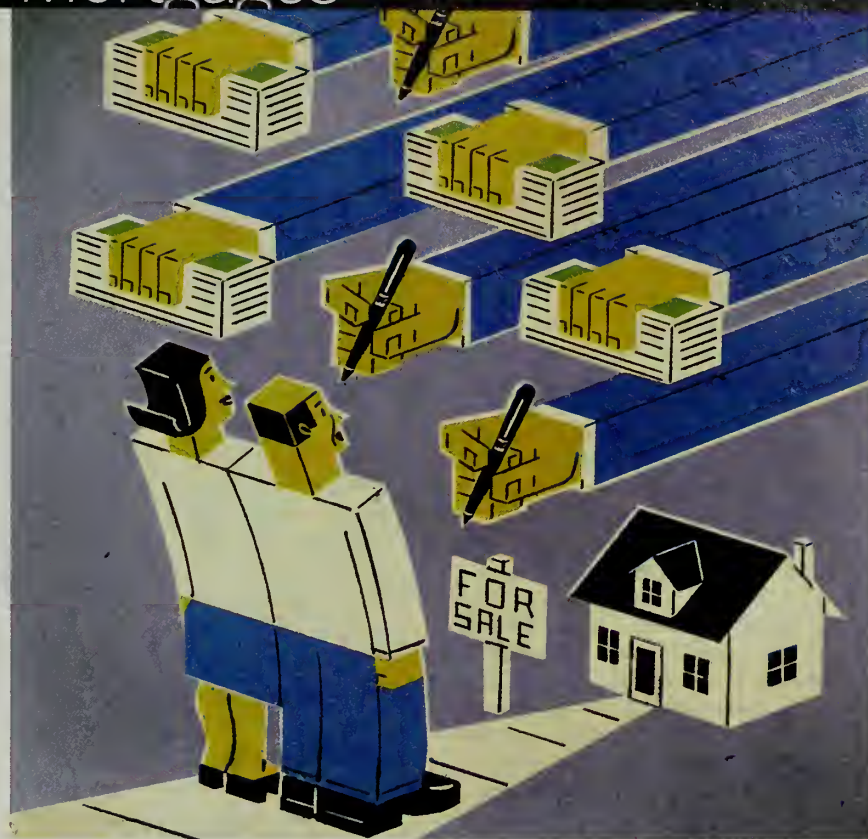
its capital tied up in German properties such as the Focus Teleport, a Berlin office building that counts DaimlerChrysler among its tenants. Declining rental income had already pushed the fund's annual return below 3%, prompting investors to withdraw more than \$1 billion in the year before the fund was closed.

Deutsche Bank's fund is hardly the first to get into trouble. Other funds have also seen huge withdrawals. Commerzbank's hausInvest europa fund, the largest German property fund, suffered a net outflow through November, 2005, of \$1.6 billion, leaving fund volume at \$10.7 billion. But so far, the institutions behind the funds have always used their resources to prevent a panic. For example, Allianz Group bought buildings worth \$2.1 billion from a fund operated by its Dresdner Bank subsidiary, avoiding a fire sale of properties to raise cash.

IN THE MEND

DEUTSCHE'S RIVALS are privately admitting that the bank, Germany's largest, didn't take similar steps, especially since there are signs that commercial real estate is improving. "We think the low point has been reached," says Peter Birchingner, an associate partner at real estate consultant Cushman & Wakefield Healey & Baker in Frankfurt. Instead, Deutsche promised only to provide "fair" compensation to people who have bought shares during the past two years. That, however, "doesn't conform to the traditional way of doing banking in Germany," says Reinhard H. Schmidt, a professor of international banking at the University of Frankfurt. Perhaps the bank's un-German move shouldn't come as a surprise, though, considering that DB Real Estate answers to Kevin Parker, Deutsche Bank's head of asset management, who is based in New York.

In fact, Deutsche Bank, which has increasingly focused on investment banking, might not be sorry to see real estate funds die out. The bank has led the drive to win government approval to create real estate investment trusts, the exchange-traded instruments popular in the U.S. and other countries. But a switch to REITs wouldn't help investors who have already sunk savings into traditional property funds. "I wanted something for retirement. I'm not a speculator," says Naab, the Frankfurt schoolteacher. Once again, Germans are discovering that risk is part of any investment. ■



So Many Lenders, So Few Takers

As housing slumps, the roof is falling in on the overbuilt mortgage industry

BY JUSTIN HIBBARD

MAYBE IT WAS THE way Alan Greenspan uttered the word "froth" this summer. Or maybe all the doom-and-gloom newspaper articles finally sank in. Whatever the cause, sometime during the last quarter of 2005, the housing boom peaked.

Not convinced? The proof is in the paperwork. Applications for purchase mortgages in early November fell below their 2004 level for the first time in six months—after a 5% drop from September to October, according to the Mortgage Bankers Assn. (MBA). By late De-

cember, applications had plunged to June, 2002 levels. The MBA expects mortgage originations to fall by 18.6% in 2006.

Even the industry's boosters are getting nervous. "There's no doubt that we're transitioning to a more challenging environment," says Richard H. Wohl, CEO at IndyMac Mortgage Bank in Pasadena, Calif. Lenders' earnings have already begun to fall. "Profitability in the industry is down, and over time that will take its toll," says Doug Duncan, chief economist at the MBA.

Suddenly the mortgage industry's lending machine looks like an eight-cylinder engine crammed into a tiny Ford Focus. During the past few years,

the industry built up enough capacity to pump out \$3 trillion worth of loans a year. Now retrenchment is in the air. The first real whiffs came in November. The nation's largest mortgage bank, Countrywide Financial Corp. in Calabasas, Calif., closed two loan-processing centers and eliminated 300 jobs. National City Corp., a Cleveland bank, trimmed 70 workers at its mortgage business and hinted at more to come. Ameriquest Capital Corp., an Orange (Calif.) lender, cut 1,500 people.

As if falling mortgage demand weren't bad enough, changing interest rates during the past year have made loans less profitable. Mortgage lenders make money by borrowing short-term funds at low interest rates and granting long-term loans at higher rates. The trouble is, the spread between short-term and long-term rates is narrowing. In fact, on Dec. 27, the yield of the 10-year Treasury note briefly dipped below that of the two-year Treasury bill; a year ago, about two percentage points separated the two. The smaller the spread between the two rates, the harder it is for lenders to make a profit.

A SHRINKING PIE

IT GETS WORSE. As mortgage demand has slowed, price competition among lenders has heated up. "There are some competitors who are pricing irrationally," says Stephen J. Rotella, chief operating officer at Seattle's Washington Mutual Inc., the nation's third-largest home lender.

The result of these forces: a shrinking pie of less-profitable loans. In October, National City said third-quarter home-loan profits tumbled 91% from last year, to \$13 million. In November, tax preparer H&R Block in Kansas City, Mo., blamed a \$72 million loss in its fiscal second quarter (since revised to an \$86.3 million loss) on a 44% annual drop in pretax income at its mortgage unit.

Who stands to lose the most in 2006? It won't be the big, diversified financial companies. When one of their business units slows, others can pick up the slack. Citigroup, for example, is the nation's sixth-largest home lender, yet it derives just 10% of its revenues from sales of home mortgages.

Companies that specialize in mortgage lending, however, face tough times. Some have taken steps to diversify in anticipation of declining business. Washington Mutual, which began life in 1889 as a regional thrift, has bulked up its re-

Feeling Loanly

These mortgage-lending specialists face tough times

MORTGAGEIT HOLDINGS

Highly dependent on sales of risky hybrid adjustable-rate mortgages to institutional investors

IMPAC MORTGAGE HOLDINGS Price pressure, high funding costs, and rising prepayments are taking a toll on gains from loan sales

AAMES INVESTMENT Rising rates and competitive pricing are diminishing the value of loans this subprime lender sells to institutional investors

HOMEBANC Gains from loan sales are falling as the company builds a lending portfolio that could lose value

NETBANK Unprofitable mortgage lending segment was recently hit with credit quality problems

tail banking operations, which now account for two-thirds of its net income. In October it paid \$6 billion to acquire credit-card issuer Provident Financial Corp., expanding further beyond mortgage sales. But to maintain its federal charter as a thrift, WaMu must keep at least 65% of its assets in real estate lending. Although that category can include loans for apartments and commercial buildings, home loans will remain a significant part of WaMu's business indefinitely.

At especially high risk: lenders that have sold lots of mortgages to so-called subprime borrowers with spotty credit records or unstable incomes. Some of these borrowers have escaped default in recent years only by refinancing at higher home values and lower interest rates, reducing their monthly payments and pulling equity out of the home to spend on other things. "If real estate stops going up, the opportunity to refinance because of a higher value is going to go away," says Michael Moskowitz, CEO at mortgage bank Equity Now in New York. "That's going to hurt companies that were doing bad business."

Companies that specialize in lending to risky borrowers include New Century TRS Holdings, Accredited Home Lenders Holding, Delta Financial, NovaStar Financial, and Netbank. If defaults rise, such lenders may have to

set aside additional money to cover losses and buy back bad loans they sold to institutions—measures that could erode their capital.

Some lenders also face the consequences of the exotic-mortgage binge that has intoxicated borrowers for the past years. Back when house prices were soaring, interest-only mortgages and called option mortgages appealed to cash-strapped but creditworthy borrowers. Those products offer low payments for the first few years of the loan, after which the monthly bill rises. Low interest rates and rapid home-price gains have allowed borrowers to refinance before the high payments came due. But with that possibility starting to fade, more borrowers may default, and fewer borrowers may take such loans in the first place. In the third quarter of 2005, the top sellers of option mortgages were Countrywide Financial, IndyMac Bancorp, Golden West Financial, North Fork Bancorp, and NovaStar Financial, according to trade publication *National Mortgage News*.

Problems with option mortgages already arising. In the third quarter of 2005, the amount of such mortgages available for sale to institutional investors from New York's MortgageIT Holding Inc. swelled to about 30% of the company's total inventory. Those mortgages carry a low introductory rate of 1% for their first month, which is usually higher than the rate MortgageIT owns them before selling them. That 1% rate brings in less money than it costs the company to finance the loans with short-term borrowing. Yields on loans held for sale fell during the third quarter, costing MortgageIT about \$18.3 million. If short-term rates keep climbing, yields could drop further.

Higher default rates, funding shortages, and overcapacity will turn some small lenders into cheap acquisition targets. Deals are already happening. In December, ARH Mortgage Inc. in Greenwich, Conn., paid \$37 million for UniFinancial Mortgage Corp. in Oak Brook, Ill., which had bought two small mortgage lenders in the first half of 2005. In September, Wachovia Corp. paid \$83 million to acquire AmNet Mortgage Inc. in San Diego mortgage bank. "We expect the declines in mortgage volumes will be a key catalyst for consolidation," says Robert Lacoursiere, an analyst at Bank of America Securities. Smart lenders will be writing on the wall early and sell before their efficiency during the cooling period. Lenders that wait to wind up selling themselves for less than the house in foreclosure. ■

Companies specializing in risky loans may face a rash of defaults



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Penney: Back In Fashion

Its private-label brands draw middle-market shoppers

BY ROBERT BERNER

RUSHING THROUGH A J.C. Penney Co. store in Plano, Tex., to buy underwear for her two girls, Anna Garlington stops to eye a pair of jeans under the a.n.a. brand name. Preferring trendier stores, the 43-year-old schoolteacher hadn't set foot in a Penney for years but was drawn by a coupon she received in the mail. The cropped jeans, called gauchos, appeal to Garlington's contemporary sense of style. "Really cool," she says, feeling the denim between her fingers.

That's the reaction Penney Chief Executive Myron "Mike" Ullman III wants with a.n.a. The stylish line of women's clothing, which is just rolling out to stores, is the retailer's largest launch ever of a proprietary store brand. It's part of a comprehensive branding strategy that Ullman hopes will bring growth to a tired section of the retail world—the middle-market department store. That runs counter to the conventional retail wisdom that the best growth opportunities are either at the discount end of the market, like Wal-Mart or Target, or the high end, like Nordstrom Inc. and Neiman Marcus.

The thinking behind the a.n.a. brand says a lot about how Ullman plans to make that happen. Penney is sharpening its understanding of its customers' needs and borrowing branding practices more familiar to a consumer-products maker like Procter & Gamble Co. than a 103-year-old retail chain. The steps are aimed at erasing Penney's image as "your mother's store" and making Penney brands res-

onate with the shopper. "So when she walks into the store she says: 'This is my store; they get me,'" Ullman says. "Most department stores don't pull that off."

The changes are already boosting results. In November, Penney registered a 3.6% gain in sales at stores open at least a year, the highest among department stores. Analysts say its Christmas sales will show it to be one of the holiday shopping season's big winners. It'll all add up to a 57% increase in earnings for its fiscal year ending in January, to \$925 million, Citigroup forecasts. But investors still doubt its long-term prospects for growth. That's why Penney's stock—trading at 13 times estimated future earnings—has one of the lowest price-earnings multiples of any major retailer and is far below its fast-growing, off-mall rival Kohl's Corp., whose forward p-e is 19. "Investors underestimate Penney, which is why there is huge opportunity in the stock," says Citigroup analyst Deborah Weinswig.

Should the growth plan succeed, it will cap a remarkable turnaround for the once-moribund Penney,

ULLMAN His middle-market push is turbocharging sales and earnings

which was operating at a loss when Ullman's predecessor, Allen Questrom, joined the company in 2000. Questrom, who retired at the end of 2004, resuscitated the languishing Penney, reinvigorating its merchandise and profits by the time Ullman, 59, took the helm. Questrom left Ullman with the largest young women's and men's apparel businesses in the country and retail Internet sales second only to those of Amazon.com Inc.

HIGH AIMS

IN THE CHOICE OF a successor, Penney needed a leader who could define a unique position in an overcrowded retail landscape—"someone who could deal with black holes," says Melanie Kuvshinov, vice-chairman of recruiting firm Heidrick & Struggles International Inc., who led the search. With Ullman, Penney got an executive known for his strategic branding skills. In his last job, he had been managing director at Paris-based LVMH Moët Hennessy Louis Vuitton, where he doubled its luxury brand holdings. Ullman has a nerve injury that l-



The retailer is adopting brand management techniques used by P&G

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its his ability to walk long distances, but it doesn't slow him down: To get around Penney's big Plano headquarters, he parks a Segway next to his desk.

For the next chapter of Penney's revival, Ullman has set his sights high, aiming to be in the top-performing quartile of retailers in five years, judged by several benchmarks. That includes new-store growth, something that has eluded other mall-based department stores. Indeed, most of Penney's new stores will be built off the mall, where Kohl's has had much success. With 22 such stores already, Ullman says there is room for as many as 200, on top of Penney's 1,000 mall stores. With Sears Holdings Corp. distracted by its merger with Kmart and Federated Department Stores Inc. planning to take its recently acquired May Department Store Co. more upscale, he sees plenty of room to grow in the middle market. Demographics are on his side, says Ullman: "42% of consumer spending is within our target market."

The core of the growth plan is Ull-

man's branding strategy. Forty percent of Penney's sales are of private label brands, the highest of any department store. Seven of those brands, such as Arizona, Worthington, and St. John's Bay, are billion-dollar businesses in their own right. But while such brands can make a retailer more distinctive and offer high margins, Ullman believes they serve no purpose unless they appeal to shoppers emotionally like strong national brands such as Nike. "We looked at them more as labels," he says. Questrom started to change that by dividing shoppers into four fashion taste levels: those who wanted conserva-

tive, traditional, modern, or trendy clothing. Now, Penney could focus its assortments around those shoppers, just as a specialty apparel store like Talbots Inc. focuses around its traditional shopper. Under Ullman, the strategy has a greater level of refinement. He's adding more modern and trendy brands, because they offer higher sales growth, and he's further segmenting those categories. For instance, Penney's a.n.a. line fills a need for casual weekend wear for women with modern tastes. It rounds out two slightly dressier modern lines launched last spring, W and Nicole, an exclusive line by designer Nicole Miller. To make sure Penney store brands stay true to their customers, Ullman is putting dedicated design teams on each. And he has launched a brand management system, much as P&G has a single brand manager on its brands. The brand

Most new Penney stores will be built off-the-mall, à la Kohl's

a.n.a. took about four months to evolve. That compares with at least a year for Penney's past brand introduction. What started as about 10 pieces of apparel for the spring season will eventually be expanded to include accessories such as jewelry, handbags, and shoes. "I want to outfit her from head to toe so she has the entire look and it is very easy for her,"

says Brian Deleu, a.n.a.'s head designer. "It completes the full brand image."

Penney's recent results suggest that Ullman's plan has struck a chord with consumers. But analysts say the biggest obstacle Ullman faces in continuing the run is Kohl's, which continues to open new stores at a far faster pace than Penney. Kohl's has been boosting the fashion quotient of its private brands, launching new ones like daisy fuentes and Candie's, partly in response to Penney. According to some analysts, Kohl's is also in talks with

PLAYBOOK: BEST-PRACTICE IDEAS

Getting Close to the Customer

J.C. Penney's growth strategy is built on launching private labels that resonate with targeted buyers. Here's Penney's formula for connecting with consumers:



DEFINE YOUR MARKET

Penney divides its customers into four well-defined fashion groups—conservative, traditional, modern, or trendy—and tailors its brands for each segment

BE CONSISTENT

Brand managers are being added to oversee each brand to ensure that apparel designs, marketing, and how the clothes are sold are consistent with the brand image

FOCUS DESIGNERS

Dedicated design teams are behind each brand so that the designers will have a deep understanding of the target customer's fashion wants



man's branding strategy. Forty percent of Penney's sales are of private label brands, the highest of any department store. Seven of those brands, such as Arizona, Worthington, and St. John's Bay, are billion-dollar businesses in their own right. But while such brands can make a retailer more distinctive and offer high margins, Ullman believes they serve no purpose unless they appeal to shoppers emotionally like strong national brands such as Nike. "We looked at them more as labels," he says. Questrom started to change that by dividing shoppers into four fashion taste levels: those who wanted conserva-

manager's role is to ensure consistency behind the brand, from apparel appearance and marketing to sales practices. "We want each brand to have a maniacal focus," says new branding head Laurie Van Brunt, who joined Penney from Limited Brands Inc., one of the few other retailers to employ brand managers.

FASTER, FASTER

THE LAUNCH OF a.n.a. also demonstrates how Penney intends to develop brands more quickly and speed up the flow of new fashions through its stores. From conceptualization to first deliveries,

designer Vera Wang on an exclusive line like Penney's Nicole and is moving toward a similar brand management system. Kohl's declines to comment.

By some measures, Penney is gaining ground on its rival. Research firm BIG search LLC shows that Penney's popularity among women as a favorite place to buy clothes rose by 13% during the last year, vs. an 8% gain for Kohl's. And Penney says the new a.n.a. brand is running 34% ahead of plan, in terms of sales. Penney can maintain such momentum, Ullman's goal to have a growth multi like Kohl's might not be out of reach.

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Helping Your Kid Slim Down

How to change behavior that can foster obesity—and its long-term damage. **BY CATHERINE ARNST**

PARENTS, WAKE UP! Almost one out of every five kids in the U.S. is obese, yet way too many parents are unaware when their child is one of the fat ones. Obese and overweight children are found in every socioeconomic and racial group. They're in the homes of college-educated parents, wealthy parents, even thin parents. Nevertheless, health experts agree that one of the biggest roadblocks to dealing with childhood obesity is denial. "Several studies have shown that parents don't recognize their children are overweight," says Dr. William H. Dietz, director of the Division of Nutrition & Physical Activity at the National Institutes of Health. "A little excess weight is now considered normal."

Not only is it not normal, it is deadly. Overweight children have dramatically high rates of diabetes, heart disease, and chronic joint problems. And no, these are not troubles that start plaguing them once they grow up; doctors regularly see high cholesterol, high blood pressure, and insulin resistance in

children. Long gone are the days when Type 2 diabetes was referred to as adult-onset.

Children are obese if their body mass index is equal to or greater than the 95th percentile of the age and gender-specific body mass charts compiled by the Centers for Disease Control & Prevention. A child who is in the 85th percentile is overweight—and at risk for obesity. If your pediatrician is using words like "at risk" or "obese," do something, now. We are not talking baby fat that will eventually disappear, not even in a toddler (and yet 10.5% of children under age 5 are considered obese). We are also not talking about predestination: Less than 5% of childhood obesity is the result of genetic or biological causes. Fat children get that way because they eat too much and exercise too little, and they could be taking the cues from you.

THE SELF-ESTEEM FACTOR

BEHAVIORS CAN BE CHANGED, however. Granted, few things are harder than motivating a child—especially a teenager—to lose weight. It's even harder if parents are obese. Start by being supportive, and let your child know your love is unconditional. Study after study has shown that children with low self-esteem have the worst outcomes on any weight-loss plan. Next, involve the whole family, even if only one child has a problem. You'll be doing your thinner kids a favor as well. As many middle-aged parents have learned, bad eating habits develop while young can become toxic later in life.

Bottom line: You're in charge. Your child doesn't have to be doomed to a lifetime of being fat. Making modest alterations to the family lifestyle can start your kid on the road to recovery or keep him/her from putting on extra pounds in the first place. So here's a top-10 list of tips for parents to keep their kids healthy:

» **Eat at home.** Fast-food restaurants, well-known fat factories, but table service establishments can be just as bad. Portions are large, ingredients are loaded with trans fats, and if you are ordering from the kid's menu, you will almost certainly end up with french fries

Change Agents

Some resources to help you help your child lose weight:

TO CALCULATE YOUR CHILD'S BODY-MASS INDEX

KidsHealth.org
kidshealth.org/parent/
nutrition_fit/nutrition/bmi_charts.html

FOR HELP IN MEAL PLANNING

U.S. Dept. of Agriculture's Food Pyramid
mypyramid.gov

FOR A LIST OF USEFUL BOOKS

American Dietetic Association
www.eatright.org/cps/ada/hs.xsl/nutrition/4927_ENU_HTML.htm

SO IN THIS SECTION:

8 | Don a mask, go to Carnival in Venice

89 | Escape winter in Belize or below

91 | Q&A: The impact of pension reform

92 | PLUS: Get fit with your iPod



Survey by the Center for Science in the Public Interest shows that a child who orders a cheeseburger, fries, cola, and an ice cream sundae off the kid's menu at one popular steak house chain ends up consuming 1,700 calories and 58 grams of

fat. That's more than the total recommended daily intake for many adults.

>>Get your kids to help with the shopping and cooking. It's a good way to get them more interested in what you're serving, and it's fun.

>>Read nutrition labels. Have you looked at what's in a Kraft's Lunchable? Or some of those so-called nutrition bars? These convenience foods are loaded with fats, carbohydrates, and sugar. They are not good for your child, no matter what their

makers say. Approach packaged foods, particularly the ones that claim they are healthy, as you would a used car: Don't believe the hype until you've read the fine print on the nutritional label.

>>Eat together as a family. Dish out the food on the kids' plates rather than serving it family-style. It will be easier to control portion sizes. And remember, kids don't need adult-size portions. "If you overfeed toddlers or young children, they will consistently seek out more than their body needs," warns Dr. Ellen Rome, director of adolescent medicine at the Cleveland Clinic.

>>Don't eat in front of the television or computer. This is one of the biggest causes of overeating, because viewers are too distracted to notice when they're full.

>>Limit screen time. Kids spend an average of 24 hours a week in front of a TV or video game, and the risk of obesity correlates directly with the amount of TV watched. Experts suggest cutting down viewing time to 14 hours a week at most. Use the time saved to go on a family walk or for other physical activities.

>>Keep junk food out of the house. It's a lot easier than saying no.

>>Take a stand against soda and juice. They are among the biggest culprits behind childhood obesity. And yes, fruit juice is full of empty calories, just like soda. Get your kids to drink water or low-fat milk.

>>Don't use food as a reward. There are plenty of better ways to motivate children—a special outing, time off from chores, even money. You could teach them fiscal responsibility along with health awareness.

>>Figure out what will motivate your child. Telling kids to lose weight because it's good for them rarely works, so come up with a goal they might actually want to work toward. "We find with girls it is often wanting to wear the latest clothes, while boys might want to be part of a sports team," says Alexandra Salazar, a clinical nutritionist at Montefiore Medical Center in New York who works with overweight children and teens.

A lot of these suggestions might seem daunting to a family mired in an unhealthy lifestyle. So don't be afraid to seek help. A doctor or nutritionist might get through to your child better than you can. They can also tailor actions to your family and convince you the changes will be worth the effort. Remember, your child will not grow out of a weight problem—it will only get worse. What better reason to take action today? ■

TIPS ON HOW TO HELP YOUR WEIGHTY CHILD

or College of Medicine
cm.edu/pa/
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Casanova Partied Here

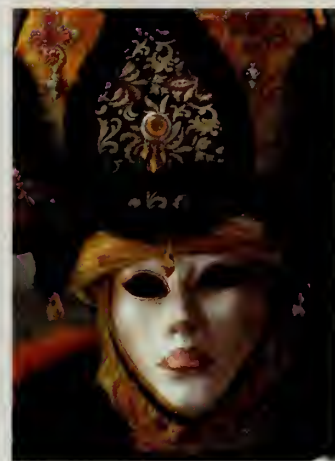
During Carnival season in Venice, masked revels are just the start. **BY MAUREEN KLINE**

BARONESS ELKE-ROMANA von Schilgen-Arnberg is convinced that even the stodgiest people love a masquerade. "They start out saying: 'I'm a banker; I can't put on a costume!' But once they're dressed up, they absolutely adore it—especially the men," says the Venice-based Austrian noblewoman who organizes parties, balls, and theatrical events.

People from all over the world flock to the baroness' half-dozen masked balls—tickets can run hundreds of dollars—that she throws every year during Carnival season in Venice (this year it's Feb. 17-28). If you were looking for an excuse to visit

Venice in winter, look no further. Caught up in all the city's parties, parades, and street festivities, you won't even notice the cold.

Carnival, which was up and running by the 13th century, is believed to have pagan roots. Still, it was tolerated by the Church as the last sinful binge before Lent. The festivities flourished until the end of the 18th century, when it was outlawed first by Napoleon and then by the Austrian occupiers who ruled the city until 1866. Stage director Maurizio Scapparo revived it in 1980 as part of the Venice Biennale, an art, theater, and film festival. "I put three magic words together—Carnival, Venice,



YOU CAN RENT ONE
Elaborate costumes are a must for the private balls

OPEN-AIR MAGIC Carnival offers street performers, film, opera, theater, and music

and theater—and it stuns, he says.

This year the city government will sponsor a series of outdoor events, including music, acrobatics, and a traditional "flight of the dove," where an acrobat descends from the top of the Campanile, the bell tower of Saint Mark's cathedral. (For a calendar of events go to carnivalofvenice.com and click on the English language page.)

ITALY MEETS CHINA

SCAPPARO'S THEATER Biennale will produce a rich program of theatrical, film, and musical events on the theme "The Dragon and the Lion," symbolizing the interaction between China and Venice. Events include a dramatization of *Invisible Cities*, a novel

by Italo Calvino, based on an imagined dialogue between Marco Polo and Kublai Khan, and Chinese student performances of operas, writers, opera singers, clowns, and acrobats; and an exhibit of costumes from Bertolucci's film *Last Emperor*. There will be an exhibit (called the "Unbidden City") that will offer continuing

programs for children. "The festival opens with an ancient Chinese fable, the story of Cinderella—700 years older than any version—performed by 15 Chinese children," says Scapparo.

At the private balls, which typically include dinner and theatrical performances, the dress code is strictly costume—mainly 18th-century velvet, brocade, lace getups complete with elaborate masks and Mozart-style powdered wigs. The baroness' Ridotto Ball on Feb. 18 features a dramatization of Giacomo Casanova's memoir, *History of My Life*, including the part where the convent opens its doors—and the nuns

bits—to the legendary womanizer. You still have time to purchase tickets at the baroness' Web site, meetingeurope.com. The Ridotto Ball—as well as the Tiepolo Ball on Feb. 23—costs 390 euros per person, about \$462. The Bal-del Doge, the most famous and grandiose of the Carnival balls, staged by costume and home-furnishings designer Antonia Sautter on Feb. 25 (bal-del-doge.com), costs 600 euros, or about \$711 per person. Another group, Incentive Harmony, sponsors three balls and an opera evening (incentive-harmony.com). The balls are the most spectacular events, but there are costumed lunches and cocktail parties as well. Top events usually sell out by the end of January.

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Why not
ay in
palace?**

You don't have an 18th-century gown and wig in your closet? No matter. You can rent costumes and masks from any of these promoters or at one of the many shops that dot the sidewalks and edges, especially around Saint Mark's Square and the Rialto. Expect to pay anywhere from 150 to 600 euros (\$178 to \$711) for one night's rental. If you're serious about attending Carnival, start making plans now. Rooms at the top hotels—among them the Danieli, the Cipriani, the Gritti Palace, and the Grand Hotel dei Leoni—are in great demand. You have other choices, of course. Some local no-frills rent out apartments and even villas. The Venice Hoteliers Assn. (www.veneziasi.it) offers online reservations for hotels and guest houses, which are more akin to bed and breakfasts. The most convenient locales are around Saint Mark's Square, but Venice is a small city, and it's easy and inexpensive to get around by *vaporetti* (public transport boats). You can also travel by water taxi or gondola. As grand as Venice's Carnival is, you don't need to stay for all 11 days of it. In fact, that may be too much. The best time to go is the last week, and especially the last weekend, when the biggest events take place. And don't rule out a trip just because masked balls aren't your idea of evening out. You can soak up a lot of excitement and spectacle of Carnival by taking a stroll, munching a *panino*, and watching the jugglers. ■

BELIZE Francis Ford Coppola's Turtle Inn



The Beach Less Traveled

These Central American spots offer adventure, nature—and plenty of sun, too. **BY AMY CORTESE**

OFFICIALLY, winter has just gotten started, but the early cold and snow make it feel like it's been around for months already. You're surely going to need a warm-weather getaway before the crocuses bloom.

It's not too late to arrange such a trip, but it may take some work and imagination. Some popular warm-weather destinations, in particular large swaths of Mexico's Caribbean coast, were ravaged during hurricane season and have only limited ability to welcome guests. Still, "if you are willing to be flexible, you can get a great deal and maybe discover somewhere new and exciting," says Amy Ziff, editor-at-large at Travelocity, the online travel site owned by Sabre Holdings.

If you were thinking Cancun, just keep heading south—way south, to Belize, Costa Rica, Panama, and Honduras. These countries share many of the attributes that make Mexico so popular:

sun-drenched beaches, coral reefs (the world's second-largest barrier reef stretches from Cancun to Honduras), Mayan ruins, proximity to the U.S., and good value. There are also rain forests, cloud forests, exotic wildlife, and volcanoes—without the crowds of Cancun.

Outside of Mexico, Costa Rica has the most developed tourism industry in the





region. Beach lovers can't go wrong at Manuel Antonio National Park on the central Pacific coast. Lush tropical forests stretch to the sea, where your biggest worry will be keeping the monkeys from snatching your lunch off the beach blanket. A wide range of restaurants and hotels is available. Try Makanda By The Sea (\$230 to \$400 a night), a contemporary hotel with breathtaking sea and forest views, or Hotel Parador, nestled in the hills on a 12-acre estate overlooking the Pacific (from \$175). All rates quoted are for high season, which starts after the first week of January and runs until Apr. 30.

Farther north is Tamarindo, a once-sleepy surfer town in Guanacaste province, where volcanic ranges give way to forests and sandy beach along the coast. Its restaurants, bars, beach parties, casinos, and surf have drawn more visitors each year, causing some locals to tag it, for better or worse, as the next Cancún. You can choose from a variety of small and midsize hotels. One standout is the Cala Luna Hotel & Villas, which features villas with private pools as well as standard rooms (\$175 to \$440 a night).

LOOK, HONEY, A QUETZAL

THERE ARE MORE secluded options north and south of Tamarindo, as well as inland. The sprawling Paradisus Playa Conchal (from \$362) offers tennis, golf, water sports, dining, and dancing. Spa lovers might pick

COSTA RICA The Paradisus Playa Conchal



PANAMA An aerial tram at Gamboa Rainforest Resort

the new Los Altos de Eros resort, 20 minutes outside of Tamarindo (\$2,150 per couple per week, breakfast only).

For something more offbeat, try Panama. If Panama conjures up

only mosquitoes and a notorious strongman, you might want to give it a fresh look. A rush of development has given it a new buzz. What other country can claim singer Rubén Blades as its tourism director?

Fly into Panama City, a booming metropolis on the Pacific coast with plenty of interesting boutique hotels. You can visit the engineering marvel that is the Panama Canal and go salsa dancing in the Casco Viejo colonial district. You can also commune with quetzals—colorful birds

TURTLE INN A dive shop, a spa, and a nearby jaguar reserve with distinct long tails—the rainforest catch waves

one of the beaches in no time.

Great deals can be found in Panamá too. One recent offering from Travelocity a stay at the Gamboa Rainforest Resort four-star property in Soberania National Park, 30 minutes from Panamá City, \$133 a night. Guests can make use of resort's pool, jogging trails, tennis court, golf course, and spa, or view the forest canopy up close from an aerial tram.

Beach lovers have plenty of options too. For some high-end R&R, try Hacienda del Mar (from \$330 a night). The sort, which features a spring-fed freshwater pool and ocean views, is on San José Island, one of the Pearl Islands in the Gulf of Panamá. On the other side of the isthmus, Isla Gran Pájaro rivals the best Caribbean spots for snorkeling and diving.

Another worthy destination is Belize, the tiny country wedged between Guatemala and Mexico. Its smattering of islands known locally as "cayes" have long attracted divers. Lately, though, this laid-back paradise is gaining a wider following

no doubt thanks to celebrity interest. In summer, Leonardo DiCaprio bought a caye on which he plans to build an eco-resort. In the meantime you can relax at Francis Ford Coppola's Turtle Inn in Cozumel (starting at \$240 a night) on Yucatán's southern coast. The inn features thatched-roof bungalows, a spa, and a dive shop, and provides a great base for excursions to ruins and a jaguar reserve.

Some of the region's least discovered beaches edge the long Caribbean coastline of Nicaragua and Honduras. Ceiba, a colorful city in Honduras, is a jumping-off point for the mostly English-speaking Bay Islands, which attract about 30,000 visitors annually. One of the area's growing popularity: Continental Airlines is expanding service from one day a week to seven from Houston to Roatan, the largest of the Bay Islands, once a haunt of pirates.

There are 11 weeks of winter left. It leaves plenty of time to arrange a winter weather escape. And, with so many options, you may want to get a jump on planning next year's trip as well. ■

A New Abacus For Pensions

The FASB rules on post-retirement accounting are changing. Benefits could suffer.

THE NATION'S ACCOUNTING RULEMAKER, the Financial Accounting Standards Board, recently announced that it will revamp how companies account for pensions and "other post-retirement employee benefits" (OPEBs)—mainly retiree health insurance. In a recent report to clients, analysts at Bear Stearns wrote that they expect this to be "the most controversial

project the FASB has ever undertaken." *BusinessWeek* Associate Editor Anne K. Gesen spoke to Bear Stearns accounting analyst Janet Pegg about what investors and pensioners can expect from the proposed changes, which are scheduled to take effect in two stages—at the end of 2006 and around 2009.

Why will pension reform be more controversial than expensing stock options?

Stock option changes have had the biggest impact on tech companies. And while many companies are reducing options awards, this has the biggest impact on senior executives. In contrast, a broad segment of employees benefits from pension and retiree health plans. Companies are already scaling back these benefits, but accounting changes could accelerate this trend.

Why the changes?

The current accounting has a lot of problems. One is that the rules allow companies to keep some of their pension and benefit liabilities off their balance sheets. As a result, many companies report healthy pension plans even though the plans are actually underfunded. Another problem is that when calculating the amount of pension income that goes to the bottom line, companies

flow from the pension plan to the bottom line. As a result, even though most companies lost money on their pension plans between 2000 and 2002, some were able to report pension income.

How is the FASB likely to fix these problems?

It's expected to require companies to put real [pension and health benefit] numbers on their balance sheets by the end of 2006. We estimate that this will cause S&P 500 company liabilities to increase by a couple hundred billion dollars. The second phase of the accounting project is expected to take until at least 2009. It's hard to predict what will happen, but the FASB will probably require companies to report gains and losses on their pension and retiree health plans that more closely resemble reality. Since returns on these plans affect the bottom line, this is going to make corporate earnings more volatile.

Will the new rules improve the quality of earnings?

Yes. Since the current rules sometimes produce numbers that don't come close to reflecting the economics of these plans, we're very supportive of the FASB's decision to take on this project.

How might companies respond?

Anything that causes earnings to become more volatile and balance-sheet liabilities to rise is going to be of great concern to firms. I wouldn't be surprised to see companies make further cuts to their benefit plans. I also think companies might change the way they invest the money in these plans to aim for less volatile returns. For example, they might

put a greater portion of their assets in fixed-income instruments. That will mean lower returns and may reduce benefits further.

Which companies are likely to report the biggest increase in liabilities for pensions and OPEB plans?

Companies in the car, steel, telecommunications, aerospace, defense, and airlines industries will be most affected. ■



use an assumed rate of return—frequently 8% or more—on plan assets. And rather than using the current value of the plan assets, companies average them over up to five years.

When the difference between a pension plan's assumed and actual returns gets large enough, a company must recognize the discrepancy—but this occurs over years. These practices artificially dampen the volatility of the returns that

EDITED BY TODDI GUTNER

FITNESS

AND NOW, THE HANDHELD TRAINER

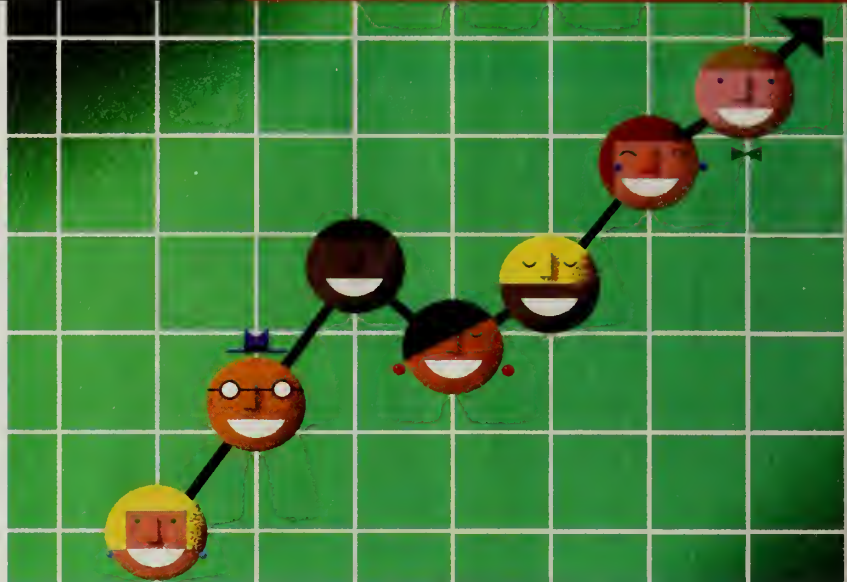
AS THE IPOD, NANO, TREO, and other handheld devices get smarter, they're taking on a new job: fitness trainer. Companies are creating exercise routines, yoga classes, and soon even triathlon training regimens that capitalize on these devices' music, color picture, and now video capabilities. Just download a program to your PC or Mac, then transfer it to your handheld.

PumpPod (pumppod.com) has more than 70 digital exercise cheat sheets to take to the gym or on a business trip. Its \$19, one-hour workouts include photo-illustrated, step-by-step instructions on how to do, say, a back squat with barbells, and guidelines for reps, sets, and rest times. You can switch

around or drop exercises on your PC to customize. The programs don't include audio, letting you play your own music.

Meanwhile, **Companion Worlds' Progio** programs, starting at \$24.95 (progio.com), made for mobile digital devices such as Hewlett-Packard's iPAQ, give you a choice of video or still photo instructions. The programs track which exercises you do and the time it takes you to do them, so you'll have a record of your progress. The first of four Dave Scott triathlon regimens, which build up to competition, is available now for \$49.95. The others will be out early in 2006.

For straight audio podcasts, **iAmplify** (iamplify.com) offers Pilates, yoga, and other fitness programs for as little as \$1.99 for a single download; a monthly subscription is \$69.99. One of the more idiosyncratic sites is **Alive Yoga** (aliveyoga.com). It records actual classes from seven yoga studios from New York to New Orleans. A download costs \$9—and the file you get may even come with a poetry reading. —*Lourdes Lee Valeriano*



STOCKS

The Helpful Index

THE NEXT TIME YOU'RE STUCK on infinite hold waiting for a customer service rep, think about whether you'd want to invest in that company. A new study shows the companies with high customer satisfaction ratings beat the market handily.

A portfolio of some 20 companies with the best marks delivered a return of 40% (excluding dividends and transaction costs), compared with 13% for the **Standard & Poor's 500-stock index** for the five-year period ended May, 2003, according to research from the University of Michigan's Ross School of Business. The portfolio also had less volatility than the index. "Customers know something about stock prices before investors do," says Claes Fornell, the study's lead researcher and director of the University's National Quality Research Center.

Topping the list of 200 companies (rated from 1 to 100) are **Apple, Yahoo!, VF Co.** and **Toyota**. The complete list is at theacsi.org. If you're scouting for investments, make sure you compare companies with their peers, says Fornell. And take a pass at any company with a rating below 50.

—*Lauren Yee*



WINTER SPORTS

IF YOUR FAMILY'S winter gear includes skis and snowboards, you can buy a carrier that will adjust for the thickness of both. The best part is it fits on the back of the car so you don't have to climb onto the roof to load it.

Yakima Products' \$169 HitchSki attaches to the rear of the car and holds up to six pairs of regular skis, four snowboards, or a combination of both (yakima.com). A lock sells separately for \$23. **Thule** (www.thule.com) also offers a similar carrier for the same price. Check the Web sites for dealers.

—*Susan Garla*

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BY MARA DER HOVANESIAN

IS A TAKEOVER AHEAD FOR AUTO LENDER **AMERICREDIT?**

OVERSEAS SHIPHOLDING'S OIL TANKERS MAY BE GOING CHEAP.

ONE RED-HOT SHANGHAI ADVERTISING AGENCY: **FOCUS MEDIA.**

AmeriCredit Speeds Up

A MERICREDIT (ACF) is the market's comeback kid. In March, 2003, the stock skidded to 1.63—down from its peak of 63 in mid-2001—after the national auto lender got hit by bad loans and, ultimately, funding woes. It's now at 25, and some pros say that it still has running room—and that AmeriCredit could be a takeover target. Hedge fund manager Tom Brown at Second Curve Capital bets that Wachovia, the No. 4 U.S. bank in terms of deposits, will bite. Last summer the Charlotte (N.C.) giant bought auto-finance outfit WFS Financial in Irvine, Calif., which, like AmeriCredit, specializes in low-credit borrowers. Says Brown: "Now that [Wachovia] is in the business, it'll get synergies from merging the two companies." Brown owned 500,000 shares as of Sept. 30. Neither Wachovia nor AmeriCredit would comment.

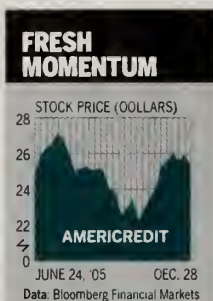
The auto loan business is ripe for consolidation. No national player owns more than 6% of any geographic market. And big banks such as JPMorgan Chase and Citigroup are hot to bulk up in consumer finance. John Hecht of JPM Securities, who pegs AmeriCredit at 33, says banks will be lured by the company's 13%-plus margins and robust growth: New loans jumped 44%, to \$5 billion, in the fiscal year ended June, 2005, and AmeriCredit sees as much as \$6.2 billion in fiscal 2006. "It has resilient margins in a rate climate where banks are getting squeezed," says Hecht. Another plus: AmeriCredit is fit enough these days to get a \$500 million refund for reserves it had paid to Wall Street loan securitizers for possible loan defaults.

A Head of Steam At Overseas Shipholding

AS THE WORLD ECONOMY expands, so does thirst for oil. The International Energy Agency sees demand rising in 2006 by more than 2%—enough to keep the crude-oil tankers cruising, says analyst Jin Chun of Maxim Group. His favorite in this sector is New York's Overseas Shipholding Group (OSG), which carries crude from drilling sources to refineries. Like most energy-related stocks, OSG has had a good run, peaking at 67.60 in August, up from 32 in May, 2004. But Hurricane Katrina and sky-high oil prices took a toll on shipping volumes, and the stock plunged 31%, to 47, on Nov. 1.

It's now at 50, but Chun says it could "easily head north of 70."

The stock trades below the resale value of the company's fleet of 61 vessels, says Philippe Lanier at Banc of America Securities. Investors are also overlooking OSG's free-cash flow of \$10 a share and profit margins above 50%. Wall Street consensus earnings estimate is \$11.64 a share for 2005 and, as shipping rates soften, \$8.71 for 2006. New CEO Morten Arntzen is expanding OSG—hauling heating oil, too. Says Lanier, who has a 12-month target of 80: "Now is a good entrance point: This is the most undervalued of the [10 shipping and refining stocks] we cover."



Focus Media: Focusing On Chinese Shoppers

CHINA IS GROWING at a 9% annual clip, and everyone seems to want in on the action. Case in point: Focus Media Holding (FMCN), a Shanghai ad outfit, saw its shares zoom 90%, to 33, after its NASDAQ initial public offering in July. The company uses flat-screen video displays in high-traffic downtowns and in retail and grocery stores—targeting a swelling consumer class. Third-quarter revenues grew 146% year-over-year, to \$19.5 million, and profits hit \$7.1 million, vs. a loss of \$1 million for the same period in 2004. "We don't think it's hyped up. In fact, it's undervalued," says Jim Oberweis, manager of the new Oberweis China Opportunities Fund. Since the fund's launch on Oct. 1, it has piled into Focus Media, at an average cost of 28 a share, making Focus its No. 1 holding. In total, Oberweis' firm owns 1.6 million shares. Piper Jaffray recently raised its 2006 earnings estimate for Focus to 82¢ a share, up 11¢, and its month price target to 40. ■



Gene Marcial is on vacation.

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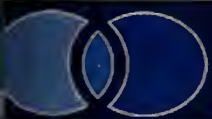
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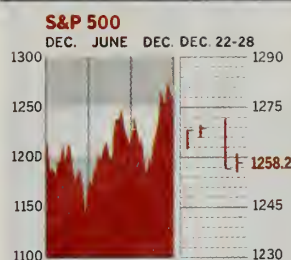
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STOCKS



COMMENTARY

The inverting of the yield curve on Dec. 27 momentarily raised up ghosts of recessions past, as economic downturns have often been preceded by inversions. Stocks took a dive on fears of a slowdown but steadied the next day on news of a rise in consumer sentiment and on signals from retailing giant Wal-Mart that holiday shopping had been fairly brisk.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	DEC. 28	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1258.2	-0.4	3.8	3.7
Dow Jones Industrials	10,796.3	-0.3	0.1	-0.5
NASDAQ Composite	2228.9	-0.1	2.5	2.4
S&P MidCap 400	744.1	0.4	12.2	12.3
S&P SmallCap 600	354.1	-0.1	7.7	7.4
DJ Wilshire 5000	12,591.2	-0.3	5.4	5.3

SECTORS

	DEC. 28	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	747.5	-0.8	6.1	6.0
BW Info Tech 100**	384.1	0.0	2.9	3.2
S&P/BARRA Growth	602.1	-0.4	3.4	3.2
S&P/BARRA Value	651.8	-0.3	4.2	4.2
S&P Energy	374.1	-1.9	29.6	30.3
S&P Financials	428.8	-0.3	4.3	4.2
S&P REIT	154.8	0.2	7.1	7.4
S&P Transportation	251.9	0.7	4.3	4.3
S&P Utilities	160.6	0.0	13.4	13.1
GSTI Internet	208.7	-0.3	17.0	16.1
PSE Technology	845.9	0.1	8.6	8.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	DEC. 28	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1521.3	1.5	8.9	
London (FT-SE 100)	5622.8	0.6	16.8	
Paris (CAC 40)	4756.9	0.1	24.5	
Frankfurt (DAX)	5447.2	0.9	28.0	
Tokyo (NIKKEI 225)	16,194.6	1.5	41.0	
Hong Kong (Hang Seng)	15,101.5	-0.8	6.1	
Toronto (S&P/TSX Composite)	11,261.2	0.1	21.8	
Mexico City (IPC)	17,690.7	-0.5	36.9	

FUNDAMENTALS

	DEC. 27	WEEK AGO	YEA
S&P 500 Dividend Yield	1.81%	1.80%	1.5
S&P 500 P/E Ratio (Trailing 12 mos.)	18.4	18.6	20
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1	16
First Call Earnings Revision*	-2.39%	-1.12%	0.2

*First Call

TECHNICAL INDICATORS

	DEC. 27	WEEK AGO	RE/
S&P 500 200-day average	1209.6	1208.4	Pos
Stocks above 200-day average	62.0%	61.0%	Nei
Options: Put/call ratio	0.70	0.67	Pos
Insiders: Vickers NYSE Sell/buy ratio	3.82	3.82	Nega

BEST-PERFORMING GROUPS

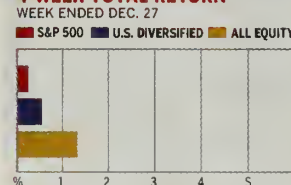
	LAST MONTH %		LAST 12 MONTHS %
Gold Mining	12.0	Oil & Gas Refining	81.0
Oil & Gas Exploration	9.5	Oil & Gas Exploration	66.8
Divsfd. Metals & Mining	9.5	Oil & Gas Drilling	56.6
Oil & Gas Drilling	9.0	Divsfd. Metals & Mining	51.7
Distillers & Vintners	7.9	Oil & Gas Equipment	49.9

WORST-PERFORMING GROUPS

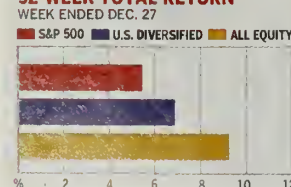
	LAST MONTH %		LAST 12 MONTHS %
Educational Services	-15.1	Automobiles	-
Home Furnishings Retlrs.	-13.4	IT Consulting	-
Automobiles	-12.5	Photographic Products	-
Computer Retailers	-10.3	Internet Retailers	-
Home Entertainment	-9.6	Auto Parts & Equip.	-

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Japan	9.4	Latin America	53.3
Diversified Pacific/Asia	6.6	Natural Resources	39.6
Precious Metals	5.9	Diversified Emerg. Mkts.	34.5
Diversified Emerg. Mkts.	5.5	Japan	33.1
LAGGARDS		LAGGARDS	
Communications	-0.8	Domestic Hybrid	4.9
Financial	0.0	Miscellaneous	5.4
Large-cap Value	0.2	Large-cap Blend	5.6
Large-cap Blend	0.3	Small-cap Blend	5.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Fidelity Japan Small Co.	15.7	ProFunds Ultra Japan Inv.	84.1
Glenmede International	15.4	ING Russia A	75.9
ICON Asia Region	11.5	Fidelity Advsr. Korea A	71.0
ProFunds Ultra Japan Inv.	11.5	Gartmore GL Ntrl. Rscs. A	63.9
LAGGARDS		LAGGARDS	
STI Sm. Cap Val. Eq. C	-18.4	American Heritage Grth.	-42.9
Bridgeway Micro Cap Ltd.	-15.7	American Heritage	-33.3
ProFds. Mble. Tlcmms. Inv.	-8.9	Frontier MicroCap	-30.8
Smith Barney Fnd. Svcs. B	-7.3	Apex Mid Cap Growth	-22.6

INTEREST RATES

KEY RATES

	DEC. 28	WEEK AGO	YEA
Money Market Funds	3.79%	3.76%	1.1
90-Day Treasury Bills	3.95	3.99	2.0
2-Year Treasury Notes	4.36	4.44	3.8
10-Year Treasury Notes	4.38	4.49	4.1
30-Year Treasury Bonds	4.53	4.68	4.1
30-Year Fixed Mortgage †	6.11	6.17	5.0

†BanxQuote

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Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BDND	30-YR. B
General Obligations	3.90%	4.0
Taxable Equivalent	5.57	6.0
Insured Revenue Bonds	3.98	4.0
Taxable Equivalent	5.69	6.0

THE WEEK AHEAD

PURCHASING MANAGERS INDEX

Tuesday, Jan. 3, 10 a.m. EST

» The Institute for Supply Management's December factory activity index is forecast to have slipped to 57.4%, from 58.1% for November. That's the median forecast of economists surveyed by Action Economics LLC.

CONSTRUCTION SPENDING

Tuesday, Jan. 3, 10 a.m. EST

» Building outlays most likely increased 0.7% for a second

straight month in November. The key number in the report will be spending on homebuilding.

VEHICLE SALES Wednesday,

Jan. 4 » December sales of light vehicles probably improved to an annual rate of 17.2 million, according to WardsAuto.com. November sales warmed up to a pace of 15.7 million vehicles.

FACTORY INVENTORIES

Wednesday, Jan. 4, 10 a.m. EST » Manufacturing inventories

probably rose by 0.5% in November. In October, inventories grew 0.6%.

EMPLOYMENT Friday, Jan. 6,

8:30 a.m. EST » Monthly nonfarm payrolls probably grew by 200,000 in December after posting an increase of 215,000 in November. Factory payrolls are expected to have expanded a third straight month, adding 5,000 jobs. Even so, the jobless rate most likely remained at 5%.

The BusinessWeek production index improved to 265.7 for the week ended Dec. 17, a 13.3% increase a year ago. Before calculation of the four-week moving average, the index rebounded to 267, from 264.7.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/ext

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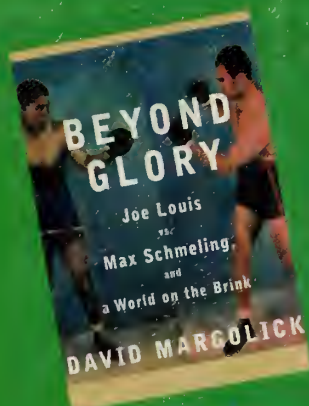
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IdeasBooks

Keep Making It New

DEALING WITH DARWIN How Great Companies Innovate at Every Phase of Their Evolution

By Geoffrey A. Moore; Portfolio; 281pp; \$25.95

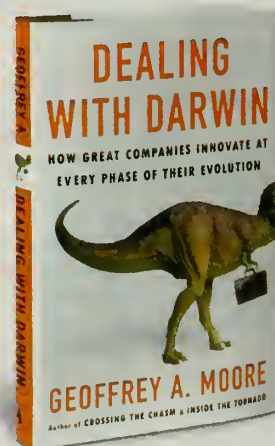
Innovation is such a loaded term: For purists, it is about creating something brand new, usually in science or its commercial extension, technology. Innovation is practiced by brainiacs in academia, in Silicon Valley startups, or in the few remaining research and

development labs bankrolled by industrial giants. But in this postindustrial world, where so much of business is services and the melding together of already existing products, such a definition is too confining. These days business-model innovations are every bit as sexy as technical marvels on slivers of silicon. And innovation isn't just for young companies or very rich ones. It's a survival tool for businesses of all sizes and at all stages of maturity.

That's the conceptual launchpad for *Dealing with Darwin: How Great Companies Innovate at Every Phase of Their Evolution*. Author Geoffrey A. Moore, a management consultant with TCG Advisors, previously published a string of product-development and marketing books focused mainly on Silicon Valley, including *Crossing the Chasm* and *Inside the Tornado*. His new volume, aimed mainly at corporate strategists, cuts across all industries and geographies.

The book's central question is: How can companies innovate continuously? He writes: "Evolution requires us to continually refresh our competitive advantage, sometimes in dribs and drabs, sometimes in major cataclysms, but always with some part of our business portfolio at risk and in play. To innovate forever, in other words, is not an aspiration; it is a design specification. It is not a strategy; it is a requirement."

While the target reader may occupy an office on the 50th floor, Moore's approach in the middle chapters is decidedly down-to-earth. He identifies



15 types of innovation and explains what kind of company at what phase of its development will get the most out of each. He explores four strategies: the growth phase of a product or service category, eight for mature phases, and three for the endgame.

Moore provides plenty of case studies to bring points to life. As an example of disruptive

Case studies in survival, across all industries

innovation in mature markets, there's the example of Dell Inc., which torpedoed its much larger PC competitors by selling direct to customers, assembling to order, and outsourcing R&D. Innovation doesn't stop when a market disappears, either. Witness Western Union. When demand for its messaging services went away, it reinvented itself in retail financial services, tapping the Internet.

Moore comes back repeatedly to Cisco Systems Inc., the leader in networking gear. Cisco faces the challenge of innovating in numerous markets—some of them young and rambunctious, others more mature.

One of Moore's most crucial conclusions is the notion that companies need to

tract resources aggressively from what calls "context" and shift them to re." Moore's definition of core may confuse some readers: It's any part of a company's business—often a new enterprise—where it's necessary to make products that are demonstrably superior to those of a competitor. Context is everything else, including well-established products, where costly improvements should be skipped because they offer little payoff. Moore doesn't redefine these terms frivolously. He's trying to get readers to think differently. Cisco's context is its established network-router business and sales to corporations in Europe and the U.S. Its core is selling new technologies, targeting telecom companies, and focusing a geographical focus on India, China, and Eastern Europe. Moore highlights the shift of resources from context to core in Cisco's \$4 billion services business. The company has split

the organization in two. Advanced Services, the core piece, focuses on face-to-face meetings with clients to help them use new technologies to transform their businesses. Drawing upon those interactions, Cisco creates prototype scenarios that can be used by less sophisticated employees to help other customers take advantage of these advanced technologies. The company then passes routine installation and operations services to its lower-skilled Technology Support Services group, which hands much of the work to partners.

Dealing with Darwin is full of caveats about the difficulties in executing these strategies. It's left to readers to customize them to fit their own situations. So this is less a cookbook than a detailed menu of meals that can be prepared to turn your competitors into dinosaurs. Brontosaurus burger, anyone? ■

— By Steve Hamm

The BusinessWeek Best-Seller List

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- 1 **THE WORLD IS FLAT** Thomas L. Friedman (Farrar, Straus & Giroux • \$27.50) *Globalization is great—sort of.*
- 2 **FREAKONOMICS** Steven D. Levitt, Stephen J. Dubner (Morrow • \$25.95) *Crack gangs, the Ku Klux Klan, and more.*
- 3 **BLINK** Malcolm Gladwell (Little, Brown • \$25.95) *Why snap judgments deserve careful consideration.*
- 4 **JIM CRAMER'S REAL MONEY** James J. Cramer (Simon & Schuster • \$26) *The CNBC commentator's trading tips.*
- 5 **THE LITTLE RED BOOK OF SELLING** Jeffrey Gitomer (Bard Press • \$19.95) *A syndicated columnist explains why people buy.*
- 6 **WINNING** Jack Welch with Suzy Welch (HarperBusiness • \$27.95) *How to succeed within a company and against the competition.*
- 7 **COLLAPSE** Jared Diamond (Viking • \$29.95) *Why civilizations fall apart.*
- 8 **THE MONEY BOOK FOR THE YOUNG, FABULOUS & BROKE** Suze Orman (Riverhead • \$24.95) *Career plans, credit, etc.*
- 9 **SECRETS OF THE MILLIONAIRE MIND** T. Harv Eker (HarperBusiness • \$19.95) *How to shape your financial destiny.*
- 10 **LET MY PEOPLE GO SURFING** Yvon Chouinard (Penguin Press • \$26.95) *Patagonia's chief on his life and philosophy.*

PAPERBACK BUSINESS BOOKS

- 1 **GETTING THINGS DONE** David Allen (Penguin • \$15) *Organizing your office and managing your time.*
- 2 **YOU CAN BE A STOCK MARKET GENIUS** Joel Greenblatt (Fireside • \$14) *Mergers, restructurings, and more.*
- 3 **THINK AND GROW RICH** Napoleon Hill (Ballantine • \$7.99) *Willpower matters.*
- 4 **RICH DAD'S BEFORE YOU QUIT YOUR JOB** Robert T. Kiyosaki, Sharon L. Lechter, CPA (Warner • \$16.95) *Starting a business.*
- 5 **THE INTELLIGENT INVESTOR, REVISED EDITION** Benjamin Graham, with Jason Zweig (HarperBusiness • \$19.95) *A classic updated.*
- 6 **A GUIDE TO THE PROJECT MANAGEMENT BODY OF KNOWLEDGE** Project Management Institute (PMI Publications • \$49.95) *Delivering results.*
- 7 **CRUCIAL CONVERSATIONS** Kerry Patterson, Joseph Grenny, Ron McMillan, Al Switzler (McGraw-Hill • \$16.95) *Talk that counts.*
- 8 **HOW TO WIN FRIENDS AND INFLUENCE PEOPLE** Dale Carnegie (Simon & Schuster • \$14) *The classic networking guidebook.*
- 9 **SHUT UP, STOP WHINING, & GET A LIFE** Larry Winget (Wiley • \$16.95) *Look in the mirror, pal.*
- 10 **GUNS, GERMS AND STEEL** Jared Diamond (Norton • \$16.95) *Why the West triumphed, by a UCLA professor.*

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in November.

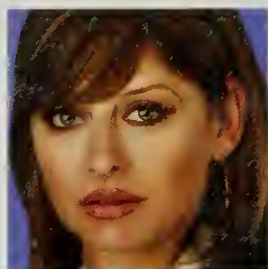
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IdeasFaceTime

WITH MARIA BARTIROMO

Stacey Snider Up Close

IF YOU THOUGHT you were up to your ears in this holiday season, just think about the pressure on Stacey Snider, chairman of Universal Pictures. In a matter of weeks, she has overseen the releases of *King Kong*, *Munich*, *Brokeback Mountain*, and *The Producers*. She also had to deal with the loss of DreamWorks to Paramount Pictures. On the eve of the *King Kong* premiere, I spoke with Snider (who, like me, works for NBC Universal, a unit of General Electric).

King Kong cost \$200 million to make and another \$50 million for marketing. What kind of return do you need to feel like it worked?

I'm no different than other studio executives: We live for the opening weekend. We are addicted to that and have created a benchmark. But in this case, [*King Kong*] has to make hundreds of millions of dollars...and needs to perform really well over time.

Does it make sense to make these expensive films?

For this one... it makes sense. When you look back at *Harry Potter*, *Spider-Man*, *Charlie and the Chocolate Factory*...you see that strong intellectual property, coupled with a state-of-the-art visual experience, [adds up to] a blockbuster. And blockbuster theatrical success tends to set up ancillary blockbuster success.

After nine months of negotiating, how did DreamWorks get away? Was there support from [GE CEO] Jeff Immelt?

You should ask him. My understanding was that there was ambivalence about the value of DreamWorks to GE.

Do you think GE will be in the movie business in five years?

I don't feel comfortable speculating about that. [GE] bought a studio not more than two years ago...and my sense is that it is committed to content. That means TV, movies, etc., as part of having a presence in a digital global marketplace.

Could you visualize an acquisition that might take Universal in a less conventional direction?

I don't want to speak for [NBC Universal CEO] Bob Wright or Jeff Immelt, but we are all keeping an eye on News Corp.'s acquisition of MySpace.com. I think some movement toward increasing more visibility in the Internet space is a possibility.

Tell me how the movie business has changed in the past five years and what it will look like in the next five years.

When I first started, all the studios were independent. Sony was owned by Coca-Cola. The studios were run by movie people, not movie people, about movies. No one said things like content is king or product or brand. We made *Sleepless in Seattle* for \$25 million. [Now] everything is much more complicated, high-risk, high-stakes. The studios are owned by big companies. Not just Universal. Paramount, Sony,

Warner Bros.—and all are subject to a different scrutiny. We are a drop in the bucket for GE's earnings, but we can embarrass them or make them proud with one release. So it's a lot more pressure.

Moviegoing has been down since 2002. Is it the explosion of DVD or are the movies just not good enough?

The choices were not as compelling this year as they have been. It's a creative business. You just churn these things out. We have trained the consumer to know that in a couple of months, you can catch it on DVD.

know that in a couple of months, you can catch it on DVD.

How about the video iPod? Does it help or hurt your business?

If we can implore the technology companies to institute meaningful digital-rights management—you can buy 1 and make 10 copies but not buy 1 and make 10—it's great for our business.

You have worked with some major people in entertainment. How do you deal with egos?

I started with Don Simpson and Jerry Bruckheimer, then Guber and Jon Peters, Jean-Marie Messier, Barry Diller...and the truth is you learn from all of them and you are honing your skills and borrowing from them and becoming your own person in the process. It's been a good ride. When I face tough times, I can look back at two truths: that I survived and learned from all of those guys and that I'm a mother. If you do it reasonably well, you can do anything. ■

Maria Bartiromo is the host of CNBC's Closing Bell.



BIG NIGHT
Snider at the
Kong premiere
with director
Peter Jackson



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Social Security: O.K., Gang, Back to the Table

THE POLITICOS in Official Washington logged some notable accomplishments in 2005: bankruptcy legislation that made it more difficult to walk away from debts, the \$14 billion energy bill that should spur more domestic production, and a \$40 billion government spending reduction bill. And there's plenty of unfinished business that politicians and policymakers should tackle in 2006, including tax reform, immigration overhaul, and tighter regulation of lobbyists. But we'd like to urge the pols to concentrate their 2006 efforts on a far more unlikely (and politically treacherous) choice: Social Security.

O.K., call us naive for encouraging President Bush to revive an issue that last year earned him the kind of political shellacking not seen since Bill Clinton's ill-starred attempt to reform the U.S. health-care system. Indeed, after almost two years of independent commission reports and seemingly nonstop town hall meetings about the looming demise of Social Security, the Administration spin doctors have fallen as quiet as church mice on the topic. But we still believe this is a debate that deserves to be resurrected—even though the politicians have moved on in search of better poll numbers.

True, the national retirement system may not exactly be in crisis as some Administration supporters all too breathlessly argued last year, but it's certainly an accident waiting to happen. Indeed, even most opponents of the President's attempt to carve out private Social Security accounts while reducing benefit levels didn't disagree with his central premise: The system's finances are unsustainable over the long haul. The key differences revolved around when the system in its current configuration would run out of money, not whether.

To revive this process, it's time for the White House to ditch all the glitzy "ownership society" wordplay and flatly tell the American people that the system needs some unpleasant—but unavoidable—preventive medicine if we are to maintain the system's (and the nation's) long-term health.

It's not hard to see why. At its inception, there were about 40 workers paying Social Security taxes for every retiree receiving benefits. Today there are three, and in about 30 years there will be only two. The Social Security payroll tax has risen to about 12% of most incomes, up from 2% at the start. Meanwhile, life

expectancy in the U.S. has reached an all-time high of 77.6 years, which means Social Security likely will have to pay out benefits longer for each worker than contemplated when the system began. The bottom line: The system can probably muddle through for 30 years but faces a shortfall of \$3.7 trillion over the next 75. The sooner we come up with ways to reduce that deficit, the better (and cheaper) for the long run.

Even fans of Social Security reform argue that the Bush Administration should hold off pursuing such risky legislation until its sagging poll ratings are higher. That's certainly good politics—but it's bad policy, for two reasons. First, a prime reason for Bush's slide in popularity, the situation in Iraq, is unlikely to change dramatically anytime soon. Free elections have been staged, but there are still thorny issues—like writing a constitution and dividing the nation's lucrative energy assets among its ethnic factions—that could prolong instability there. In short, for the rest of President Bush's term, there will always be another mountain to scale in Iraq. So he cannot wait for sunnier days; he has got to move ahead boldly. The alternative

policy paralysis quickly followed by true lame-duck status, is simply unacceptable.

Second, the Administration's days are numbered. After the November elections, especially the GOP's slim majority in either house shrinks sizably, it's less likely Bush will have the clout to tackle such a contentious issue. So he should act now to protect future retirees—and taxpayers.

In his first term, President Bush surprisingly showed that

The debate needs to be resurrected despite considerable political risk

politician can touch the so-called third rail of American politics and survive. Now it's time for him to reopen that national debate on Social Security, this time scrapping the rhetoric about private accounts (which do little to solve the looming funding shortfall, anyway). Instead, Bush must accept the message the public sent loud and clear—that Social Security should remain a safety net program rather than morph into an investment vehicle—and lead the nation in finding ways to assure the program's long-term viability. Because any solution will likely contain a mixture of benefit reductions, longer work lives, or higher payroll taxes, that's a charge few politicians want to lead. But if Mr. Bush is really serious about ensuring the long-term viability of Social Security, then what better legacy can he leave than being called the President who took the entitlement program—even when the smart political money advised him to cut and run?

Business Week

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DREAM MACHINES

the future of cars: Smart tech, sizzling design, more choices

BY LEE WALCZAK AND DAVID WELCH (P.52)



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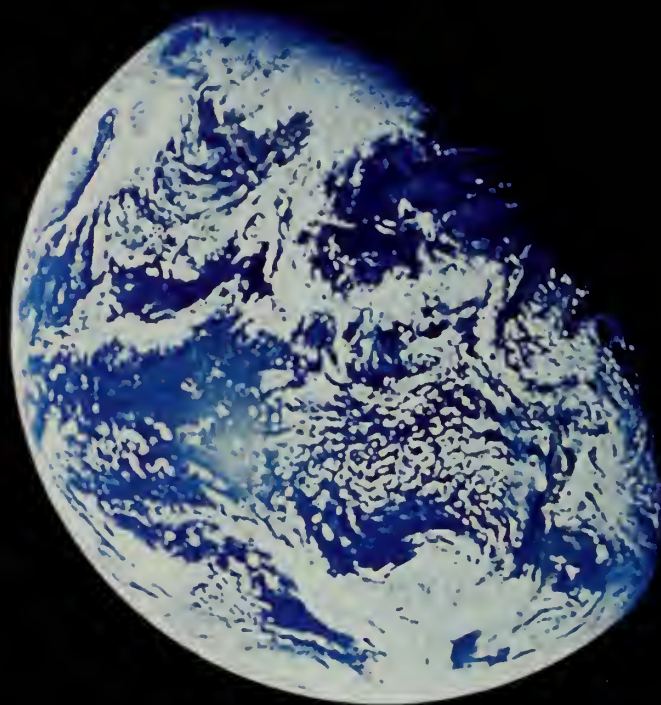
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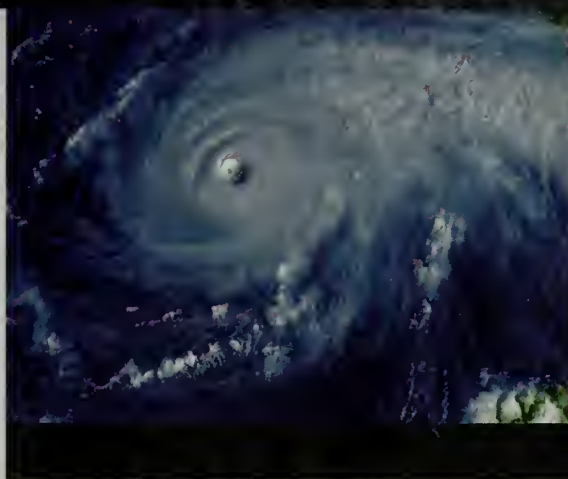
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"HENDRICK'S" WON

THE GIN CATEGORY...

- THE WALL STREET JOURNAL

THE WALL STREET JOURNAL.

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FRIDAY, AUGUST 29, 2003 - VOL. CXXIII NO. 43 - ***** \$1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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A 1954 Bonneville prototype up for auction in 2006

Test Drives at BW Online

With this week's Dream Machines Cover Story, BusinessWeek Online unveils an all new **Autos channel**. Every day you'll find breaking news, reviews, sneak peeks at the latest designs, car tips, and more. On the **Autos home page** you can use the Build-Your-Car tool provided by J.D. Power & Associates to browse and equip models and compare prices and features. **Auto Reviews** details the good, bad, and bottom line on luxury models, economy cars, and everything in between. Follow the trends and strategies shaping cars—and the industry—at **Auto Design**. **Classic Cars** has lots of advice for buying and owning a vintage vehicle, while **Hybrids** features news, tools, and reviews on this fast-growing new category. And for crash-test ratings,



2006 Honda Gold Wing, with air bag



Citroën C-SportLounge 2006 concept car

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JP Front

"I am not trying to be heroic or controversial."

—Piper Jaffray analyst Safa Rashtchy on setting a \$600 target for Google's shares in 2006, to AP

EDITED BY DAN BEUCKE

HEEL ESTATE

BABY ON BOARD AT CHRYSLER

IL CHRYSLER build a grown-up version of its Baby Bentley? After hitting a home run with the in-your-face looks of its 300 sedan (below), which some think resembles a Bentley, Chrysler is testing the waters with a luxury car built on the same platform. At the Detroit auto show, which opens to the media on Jan. 8, Chrysler will show off the Imperial, a concept car named for its boulevard boat



of the '60s. The Imperial is a few inches longer than the 300, with a posh cabin. Seats have two-toned leather, and front and rear doors open away from each other to let passengers in and out more easily.

Chrysler insiders are cagey about whether the car will be built. It helps, though, that Chrysler is likely to produce the Dodge Challenger concept. That knockoff of a 1970 Challenger also uses the 300 platform. Meanwhile, the company is taking a baby step: Recently, it commissioned an Ohio company to stretch a few thousand 300s to sell as personal limos.

—David Welch



WIRED WORLD

A Cool But Safe Hangout?

NICK LACHEY, SOON-TO-BE ex-husband of starlet Jessica Simpson, wants in on the social networking action. On Feb. 1 he'll launch **Yfly.com** with buddy A.J. Discala and entrepreneur Drew Levin. They hope to make it a **MySpace.com** for young teens. The site will sport cool technology such as wireless messaging direct from the site. But what really sets Yfly apart is a focus on safety. When teens enter personal info, a button pops up, prompting them to consider that parents, teachers, or predators might be reading in. Teens are invited to join by others in their school, so unfamiliar names can be singled out. And **WiredSafety** consultant Parry Aftab will watch for outsiders.

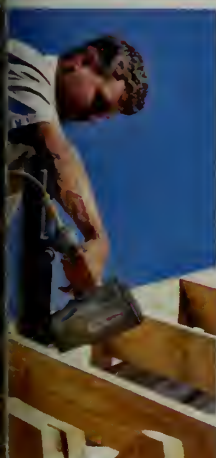
Lachey says he got behind Yfly after learning that his identity is one of those most frequently used by predators to lure teens. A December poll of 1,468 teens by the **Polly Klaas Foundation** found half have exchanged messages with someone they don't know. "It's disturbing to hear someone is using your name and identity to commit these horrible acts," Lachey says. His name is sure to generate buzz. But it's possible a safety-oriented site will come off like your mom's after-prom party. Cool is hard to manufacture, even for a heartthrob. —Jessi Hempel

THE BIG PICTURE

RISE THE ROOF Construction wages average about \$19 an hour in the U.S. But some areas pay better than others:

Pay differential to the U.S. average

HARTFORD	+38%
ANCHORAGE	+30
NEW YORK	+27
SAN FRANCISCO	+27
CHICAGO	+23
GREAT FALLS, MONT.	+22
BROWNSVILLE, TEX.	-30%
BIRMINGHAM, ALA.	-24
SAN ANTONIO, TEX.	-21
CORPUS CHRISTI, TEX.	-20
CHARLESTON, S.C.	-19



Pay differentials from National Compensation Survey of the Bureau of Labor Statistics, 2004 data, latest available

THE DEAL MILL

J&J'S FIRST AID FOR GUIDANT EXECUTIVES



IT LOOKS MORE AND MORE as if Guidant shareholders will have to make do with a lowered bid from Johnson & Johnson. Yet the money J&J is offering senior Guidant execs is growing. In a Dec. 23 Securities & Exchange

Commission filing, J&J says it boosted payouts, contingent on the merger's completion, to more than a dozen Guidant higher-ups by \$5 million. As reported by Footnoted.org, CFO Keith Brauer will receive \$2.7 million (up \$108,000 from March, 2005) and Fred McCoy, president of cardiac rhythm management, will get \$2.3 million (up \$210,000). And a group of nine unnamed execs, originally to receive \$13 million, has been expanded to 11, with \$17.2 million in pay. Not included: former CEO Ronald Dollens or Chairman and interim CEO James Cornelius.

Charles Elson, a University of Delaware governance expert, says the payouts appear to "sweeten J&J's offer." Guidant's board has backed J&J's bid heading into a Jan. 31 shareholder vote, despite a higher offer from Boston Scientific. J&J and Guidant declined to comment. —Elizabeth Woyke



SNEAKER ENVY

IT'S THE PRICE of product placement: Create a special pair of shoes for a hit movie, and fans may clamor for them. Al Cabino, a twenty-something sneaker enthusiast from Montreal, loves the moonboot-like Nikes worn by Michael J. Fox (above) in *Back to the Future II*. Two months ago, Cabino started an online petition to get Nike to produce them. "They're the most mythical sneakers in film history," he gushes. So far, Cabino has 3,500 signatures from 30 countries. There's a precedent: Fans got ASICS to make a small number of shoes worn by Uma Thurman in *Kill Bill Vol. 1*. Nike, while flattered, says it has no plans to deliver. —Elizabeth Woyke

BLOGSPOTTING

TEEN TRENDS, FROM THOSE IN THE KNOW

Ypulse.com

» WHY READ IT: To find the latest craze among tweens and teens. Anastasia Goodstein, an audience participation manager for Current TV, keeps tabs on trends that resonate with teens and highlights those that flop, helped by a handful of teen bloggers.

» NOTABLE POST: On the new popularity of participation-oriented rock bands: "This isn't going to replace 50 Cent or Holla Back Girls anytime soon, but...it is part of a huge influence informing everything from fashion to magazines to iPod cases."

DRAWN & QUARTERED





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Our best service anticipates your needs. To give you the best possible sleep, we used the latest in cushioning technology to create an even more comfortable flat bed. And to add to your comfort, we included plumper pillows and cozier blankets. Our goal is simple: to deliver the best service you could ask for, without you having to ask. So whether you're enjoying a gourmet meal, or an Arrivals Lounge that feels more like a spa, we think you'll find our business class like no other.



BOOKS



CHOCOLATE MESS

When a new biography of Hershey founder **Milton S. Hershey** hits stores this week, it will sport a disclaimer saying the book is "Neither authorized nor sponsored by the Hershey Co." That settled a lawsuit claiming the cover (above) infringed trademarks. But according to the author, this was more than a dustup over a dust jacket.

Michael D'Antonio says that in early December a Hershey official demanded changes in *Hershey: Milton S. Hershey's Extraordinary Life of Wealth, Empire, and Utopian Dreams* (Simon & Schuster). The author declined, and the lawsuit followed. Hershey now says it is satisfied.

But D'Antonio says that in Hershey, Pa., anything challenging the founder's reputation is still a hot potato. The book alleges that accounts may have been "jiggered" to extract a premium for a caramel company Milton sold in 1900 and that he was a heavy gambler. "It's common for people here to think of him as a saint," notes Pamela Whitenack, director of the Hershey archives. —Hardy Green

E-TAIL DETAIL

A WEB OF NEW TAXES ON ONLINE SALES

THE DAYS OF AVOIDING sales tax on the stuff you buy online may be numbered. Salivating over booming Web purchases—\$30 billion this holiday season, by some measures—states are taking the first steps toward requiring retailers to collect taxes on Internet and mail-order sales. And 2006 will see a bipartisan push in Congress to O.K. the levies.

Since 2000 nearly all of the 45 states charging sales taxes have worked together to establish a simplified and relatively uniform collection system. The project was started after Congress barred states from taxing Internet access and began pressing governors to curb taxation of Internet-based sales. The Supreme Court has prohibited states from requiring out-of-state sellers to collect the taxes, largely because of a



morass of multiple state and local levies. Now, 13 states, including Michigan and New Jersey, have adopted a streamlined system aimed at satisfying the court's concerns. Six other states have started incorporating the changes into their own laws. Senators Mike Enzi (R-Wyo.) and Byron Dorgan (D-N.D.) are asking Congress to give those states the go-ahead to collect sales taxes from e-tailers.

Not surprisingly, bricks-and-clicks retailers back the change. (Many voluntarily

collect taxes on their own online sales.) But expect a fight in Congress, with Web heavyweights such as **eBay** and **Amazon** leading the charge. They'll have the support of anti-tax Republicans in the House as well as the White House. But with California and others likely to sign on to the simplification plan, pressure to approve the changes is building.

One holiday season soon don't be surprised to see sales tax included when you click on "place your order." —Howard Gleckman

DOGFIGHTS

THE RIVAL ON EL AL'S HORIZON

THREE YEARS AFTER going private, **El Al** is one of the world's most profitable airlines. Higher fares and an 18% rise in passengers more than offset higher fuel prices and the cost of the Israeli airline's rigorous security measures. But El Al may soon face its first Israeli competition. The government, hoping to bring in a million more tourists in 2006, will decide soon whether to grant **Israir**, a low-cost startup, permission to fly the lucrative



Tel Aviv-New York route.

Having operated thrice-weekly charter flights, Israir wants to launch daily service. Industry insiders say the government is leaning toward approval. But El Al claims the government pledged not to permit a second carrier unless El Al missed traffic benchmarks. El Al Board Chairman Israel "Izzy" Borovich, who controls a majority stake, says the airline has met those conditions. —Neal Sandler

THE STAT

10

The percentage of total costs that financial-services execs plan to move offshore this year. For 2010 the figure is 20%.

Data: Deloitte Touche Tohmatsu study of 62 global financial-services institutions

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As a business owner and a woman, I want to thank you for allowing my invisibility to remain intact for 2006."

—Kristina Halvorson
Minneapolis



BLUNDERS AMONG OUR 'BESTS'

YOUR WRITER erred in trivializing geography as "so 20th century" ("Best Ideas," "The Best of 2005," Cover Story, Dec. 19). Geography as a discipline studies the cultural and physical interactions of this world. Our global linkages make application of this type of knowledge strategic. Perhaps what your writer wanted to say was that location is no longer a defining parameter for work. That is the rich style of analysis I have come to anticipate from *BusinessWeek*.

If this seems like a curmudgeon's comments, well, yes, I have a graduate degree in geography that continues to serve me well in my business career. Having the technical skills, tools, and inclination to evaluate business problems over space as well as time results in effective solutions that actually can be implemented.

—Judith A. Cichowicz
Seattle

I WANT TO congratulate you on your backward slide into the Dark Ages with "Best Leaders" (Cover Story, Dec. 19). Of the 21 leaders you recognize, only two are women: Caterina Fake of Flickr and

Marissa Mayer of Google Inc. I'm especially delighted to see that you chose to depict Mayer as a leggy blond cartoon character. Nicely done. As a business owner and a woman, I want to thank you for allowing my invisibility to remain intact for 2006.

—Kristina Halvorsen
Minneapolis

WANT A CUTE CROSSBREED? CHECK OUT YOUR NEAREST SHELTER

RE "HOW MUCH is that (designer) dog in the window?" ("Best Ideas," Cover Story, Dec. 19). Puggles are a "best idea." Try telling that to the thousands of mutts that die in shelters every day—some of them pug/beagle mixes—because people see a flashy price tag and think it means a better dog. For every Puggle bought, more pug/beagle mixes (without the fancy name) are killed in shelters.

I, for one, am ashamed that you would think the selling of a mixed-breed dog at a high price is a good idea. This is a scary ripping off hapless consumers who do not know any better. The average price of a shelter dog? In Ohio, \$8 and a photo I can get you a Puggle. Or a Doodle, or a Cockerpoop, or just about any other mutt.

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PRINTED IN THE

designer doggie—a person could want.
—Stacey Webb
Greater Ohio Boxer Rescue
Toledo

THERE IS NOTHING designer or magical about these dog crossbreeds. They are produced to make money, with little regard for the long-term consequences. Cross-breeding can also produce a dog that has the worst attributes of its parents. And even if the dogs themselves are wonderful, they are often purchased on impulse, with little thought to how a dog will fit into a family's life. Adopting a dog from a shelter or a rescue group: Now there is one of the truly best Ideas of 2005."

—Eleanor S. Campbell
Chester, N.J.

DO BORDER COLLIE and Australian Shepherd rescue. There are lots of advantages to purchasing or adopting an adult dog. The five windowsills in my house that have been chewed by foster puppies and the carpet that needs replacing from all the abuse-training I've done attest to that fact.

—Tracy Daniel
Montgomery, Ala.

HOW A WORD FROM THE OF MARTHA'S APPRENTICES

As a CONTESTANT on *The Apprentice*: Martha Stewart, I feel the need to address comments made by Martha Stewart to *BusinessWeek*, where we were referred to "opportunists" and "exhibitionists" "consider myself the visionary still," (People, Dec. 19). I hoped she had been misquoted since her entire cast has given me the professional courtesy of not voicing any negativity about her.

As a professional and a business owner, I came to *The Apprentice: Martha Stewart* with some apprehension. As contestants, we gave up weeks of our personal and professional lives for the opportunity to work with Martha as she reinvented herself after her incarceration. We did this not as opportunists but with the hope that we could work with a proven business leader. I treated Martha with respect, admiration, and a desire to learn from her the entire time we were there.

None of us needed to reinvent ourselves. We were all, and are, successful in our own right. I suppose you can argue that my participation in the reality television genre makes me an "opportunist" or "exhibitionist," but any fame or fortune generated was short-lived (thankfully so). I am proud to say that I have happily returned to my life and put this experience behind me. Per-

CORRECTIONS & CLARIFICATIONS

In "Helping your kid slim down" (Personal Business, Jan. 9 issue), Dr. William H. Dietz's affiliation is incorrect. He is director of the Division of Nutrition & Physical Activity at the Centers for Disease Control and Prevention.

haps Martha should do the same, with dignity, without malice or insult.

—Chuck Soldano
Philadelphia

PATENTS: HINDSIGHT IS 20-20 VISION

"THE BLACKBERRY widow's tale" (News: Analysis & Commentary, Dec. 19) clearly demonstrates that an expert for pay is willing to say that an invention is obvious after seeing the results. But was it obvious to the expert before he saw the invention, and if so, why did he not develop it? It is amazing how everything falls into place after seeing the results.

The whole issue of "obvious" is subjective, and it always depends on the U.S. Patent Trade Office Examiner, the judge(s) and possibly the jury, and how persuasive the patent attorney is.

The inventor should be rewarded for his intellectual contribution, or the company can wait 20 years and use the invention freely—a simple choice.

—Harold Nissen
Scarsdale, N.Y.

U.S. SCIENTISTS NEED CAREER PATHS WITH A FUTURE

INTEL CORP. CHAIRMAN Craig R. Barrett is about half-right in his essay "A corporate science project," on America's failure to prepare our young leaders to carry the mantle into the global technology battles of the future (Outside Shot, Dec. 19). Barrett failed to mention the other half of the equation for developing scientists, engineers, and math majors in our colleges and universities, which is a vision for corporate long-term career paths.

As a retired veteran of the Silicon Valley technology corridor, I had the pleasure of working with many top technologists laboring on the most advanced projects, civilian and military, that introduced the desktop computer, the Internet, optical storage, lasers, and high-density microprocessors, to name a few. America's advanced-technology corporations (including Intel) have changed drastically over the past few decades, and while they still seek the best minds American universities have to offer, they also have a dark

reputation of sloughing off those dedicated employees as they approach 40 years of age. Worse, they add insult to injury by forcing long-term employees to train new hires to take over their jobs.

It is fortunate that Andrew S. Grove was a co-founder of Intel in the 1960s, as his chemistry degree probably wouldn't qualify him for long-term employment at that same company today unless he were willing to relocate to Asia and take a drastic pay cut.

—Tom Carroll
Madisonville, Tenn.

ANOTHER FOUNDING FATHER OF FLAT PANELS

RE "FLAT-PANEL pioneer" (Voices of Innovation, Dec. 12): While conceding George H. Heilmeyer's priority in building the world's first liquid crystal displays, in all fairness I have to point out that his approach, using the "dynamic scattering" mode of liquid crystals, never advanced beyond creating simple wristwatch and pocket calculator type displays. The real breakthrough occurred in the early '70s, with the introduction of the "twisted nematic" mode of liquid crystal operation and the invention of "active matrix" addressing, using thin film transistor arrays, with the undersigned being responsible for the latter. My pioneering paper, entitled "A 6 x 6 Inch 20 Lines per Inch Liquid Crystal Display Panel" was published in the *IEEE Transactions on Electron Devices* in 1973 and is generally credited with forming the basis of today's worldwide expansion of liquid crystal display technology. I am also responsible for the introduction of the term "active matrix" into the literature.

—T. Peter Brody
President
Advantech US
Pittsburgh

How to reach BusinessWeek

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Technology&You

BY STEPHEN H. WILDSTROM

Treo: Opening New Windows

Palm users who pick up the new Treo 700w are in for a jolt. Just below the screen is a Windows key that makes it clear this is different from any product in Palm's 10-year history. Folks who use Microsoft's Windows Mobile software on a Pocket PC or smart phone will get a few surprises as well. The new Treo is different from any other Windows device.

When Palm licensed the Windows Mobile 5.0 software last year, it won unprecedented permission to make substantial changes in Microsoft's basic software. It has made the most of this freedom, drawing on its experience with keyboards to eliminate many of the annoying usability problems that have plagued Windows Mobile devices, particularly phone-equipped Pocket PCs.

One result is that the Treo 700w (\$400 from Verizon Wireless with a two-year contract) is the first Pocket PC whose stylus will rarely leave its storage slot. The basic layout of the keyboard is similar to the Treo 650. The main difference is the addition of the Windows key, which brings up the Start menu, and an O.K. key, used to complete most actions. These replace the Calendar and Mail keys on other Treos. Two cell-phone-style soft keys, whose functions vary with the operation at hand, replace Palm's Menu and Home buttons.

Palm has drastically changed the Pocket PC home screen for the better. Instead of a jumbled list of choices, the Treo home screen features speed-dial buttons and two boxes where you can enter text. The one at the top picks names from your contacts as you type. The lower one is for Google searches. The battery gauge at the top remains visible on all pages, overcoming one of Windows Mobile's silliest shortcomings.

THE STYLUS SHOULD BE SUPERFLUOUS as an input and navigation tool on any device equipped with a keyboard. You hardly need to use one with Windows Mobile 5.0 software, which is showing up on various devices in addition to the Treo. But on most systems there will be one critical task that requires tapping the screen—such as changing some of the settings on the Tab key. On Pocket PCs, you can't do that from the keyboard, but on the new Treo, you can. There are still occasional annoyances. As you type text, the Pocket PC software suggests word completions. The only way to accept one, if you really feel the need, is to tap the screen. But you can also ignore the suggestions and just go on typing.

Other Palm innovations go beyond fixing Microsoft shortcomings. One simple but valuable one is the ability to



program speed dials with the codes and passwords needed for access to voicemail. You can also program such buttons as forward, back, and delete with the appropriate digits. Unfortunately, these codes can only be single digits, which won't work with many corporate voicemail systems.

Another innovation adds a new option called "Ignore with SMS" to the handling of incoming calls. This is a real boon at business meetings. Instead of just shunting a call to voicemail, you can send the caller a text message—handy in a setting where tapping out some text is acceptable, but answering the phone is not.

The Treo runs on Verizon's fast BroadbandAccess network, making it ideal for data. Palm designed the Windows Treo primarily in response to demand from corporate customers, and once the appropriate software is finished, it

will be able to receive corporate e-mail and other data automatically from BlackBerry, GoodLink, and Microsoft Exchange Server 2003 services (BW—Jan. 9).

I've been using Palms of one sort or another for a decade, and at first the Treo 700w seemed a little weird. Many Palm aficionados will prefer to stick with the familiar Treo 650. For one thing, it offers a better display since Palm actually had to reduce

The 700w runs on Microsoft software—and spiffs it up, too

resolution to meet Windows standards. But Pocket PC users and many newcomers to high-end smart phones will find the Treo 700w a delight. It's by far the best Pocket PC I have used and the first one that I have ever really wanted to carry. ■

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Old Media's Mobile Future

When it comes to broadband, America is old school. A recent Federal Communications Commission study showed it ranked only No. 16 among the world's most broadbanded countries. Much the same holds true for mobile phone use; for those devices, media possibilities have barely been plumbed in the U.S. ¶ So there should be much to learn from countries that

were early adopters, and from people who spend an abnormal amount of time studying them, like Jeffrey Cole. As director of the University of Southern California's Center for the Digital Future at the Annenberg School for Communication, he oversees the World Internet Project, which has tracked the Net's impact in 20 industrialized countries since 1999.

Cole is ridiculously well-versed in different nations' media habits. Swedes, way ahead of the curve in adopting new technologies, still read newspapers far more than Americans. Massive TV screens and TiVo are largely U.S. phenomena. Newspaper penetration in China is low, but the Chinese trust Net info more than most other nationalities; the Japanese trust it the least.

Cole is convinced that U.S. teens will carry their text-message-happy, media-mash-up ways into adulthood. "The ability to move media from platform to platform, on whichever screen they want and whenever they want, [will be] an absolutely dominant feature for the rest of their lives," he says. This is bad news for radio and newspapers; his data shows newspaper readership in America dropping faster than in other countries. TV-watching took an early hit when the U.S. was a dial-up nation, but Cole believes that TV will persist. (Lest you peg him for another doom-and-gloomer, Cole is quick to stress it will be decades, not years or months, before established media formats die off.) Of course, our conception of TV itself may change. Cole is almost alone in predicting that Americans will watch longer-form video on their phones and iPods—think 30-minute sitcoms, though not three hours of *King Kong*.

Mobile is where battered American media companies may find new paying customers for their content—more on this later—but Americans' transition to more mobile media habits won't happen overnight. Life in the U.S. is characterized by large personal spaces (big houses for big-screen TVs) and solitary car rides to work, points out Rishad Tobaccowala, chief innovation officer of Publicis Groupe. Compare this with Japan, says Cole, where train commutes are long and home Internet usage is lower, all of which made a ripe market for

Traditional content will survive, but it will keep morphing



multimedia phones. Still, despite Americans' notorious fondness for bigness, Tobaccowala and Cole agree a small-screen mobile future looms here, as well.

Which would mean more bad news for traditional content players, right?

Actually, no.

There is a key difference between content on the Web and content on cell phones and iPods: Consumers are willing to pay for content and services on mobile devices. (Think iTunes and text-messaging.) This is why U.S. content players ranging from ESPN to American Media Inc.—publisher of *Star* and *National Enquirer*—have reported pleasant jolts of new revenue from mobile applications, as consumers pay for sports and celebrity news updates. Youths in South Korea—who have the most technologically advanced media habits, says Cole—spend serious money for mobile data and messaging. According to media consultant DhaliwalBrown's *mobileYouth* study, they spend \$2.6 billion for mobile media in 2006 and \$2.9 billion '07. Now consider how few companies, anywhere, have figured out a way to make a buck selling Web content.

For all the talk of convergence, media behavior doesn't often hop across platforms. The Web trains users to expect free content, but such expectations haven't migrated to mobile devices. Therein lies a silver lining for traditional media—including newspapers—in the move to mobile. It's a new way to charge for content. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia



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[†]Source: MORNINGSSTAR[®] 11/30/05. For each fund with at least a 3-year history, Morningstar calculates a risk-adjusted return measure that accounts for variation in a fund's monthly performance (including the effects of all sales charges), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive a Morningstar Rating[™] of 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a portion of one fund and rated separately.) Morningstar Rating[™] is for Class A shares only; other share classes may have different performance characteristics. ©2005 Morningstar, Inc. All rights reserved. The information contained herein is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.



The Barker Portfolio

BY ROBERT BARKER

Hit a Few, Miss a Few

I've just taken my customary look back at columns in the past year or two to search for those that time and events belied. A keyword in that search: Google. The juggernaut's shares recently topped 446, which you probably would not have missed even if you spent 2005 under a rock. That's where I must have been back

in August, 2004, when Google sold stock at 85 in an initial public offering. I didn't like Google's unwillingness to discuss business in the sort of detail to which investors are accustomed, seeing that as inherently too risky. The market disagreed, valuing Google's staggering growth in cash flow more than corporate transparency.

Chalk it up as a big one—make that a leviathan—that got away. In my own defense, lots of my calls panned out. Among them: columns on AT&T (before SBC Communications bought it and took both the name and ticker symbol), Callaway Golf, CarMax, Devon Energy, eBay, EnCana, Hospira, and Office Depot. Yet those that really riveted me are the ones that went awry (charts).

MOST NOTABLE among these were many bearish outlooks on stocks that surged, including the IPOs of Domino's Pizza and Herbalife. At Domino's, higher same-store sales and lower cheese costs widened margins, while network marketer Herbalife is enjoying faster-than-forecast revenue growth. It sees midteens percentage gains in 2006 sales. I also erred on fashion retailers, both in a piece on women's clothier Chico's FAS and a second on "teentailers" such as Abercrombie & Fitch. Of Chico's, I was dubious about a plan to keep expanding its number of flagship stores while integrating the acquisition of a smaller chain, White House/Black Market. Yet

management has been able to maintain its wide gross margins, lifting cash flow through 2005's first three quarters by 37%. The ever-volatile teentailers proved more mixed, but most kept posting neat same-store sales gains, confounding my fear of lofty multiples and high levels of insider selling.

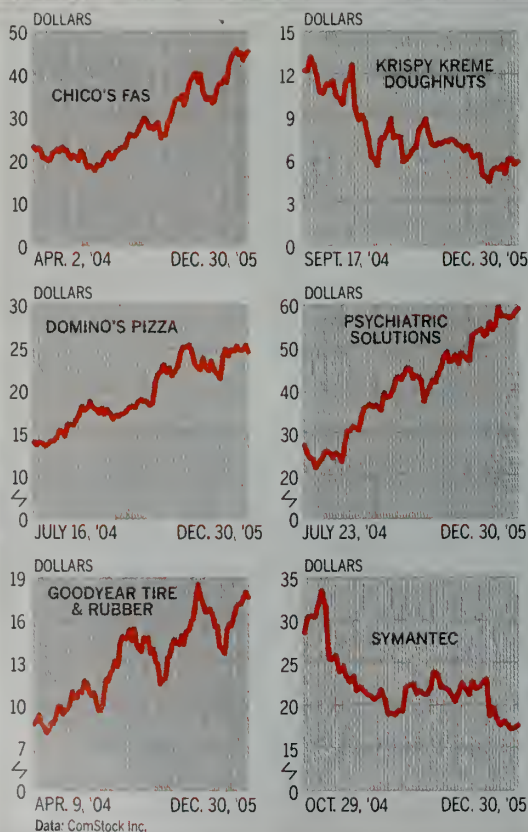
Goodyear Tire & Rubber proved quite a different story. Back in April, 2004, when I judged it too risky even for contrarians, the company was the subject of a Securities & Exchange Commission investigation into its accounting practices. In August, the company was notified that the SEC staff planned to recommend an enforcement action against Goodyear said it was cooperating with the SEC. I was also worried about Goodyear's balance sheet, and while it remains highly leveraged, quarterly sales are setting records—more than enough to assuage investors. Similarly, my concerns about regulatory woes in Florida for a unit of Psychiatric

Solutions, which operates mental health centers and services, proved unwarranted. The company keeps growing rapidly, in part through acquisitions.

Most of my bullish assessments worked out better, no doubt in part because of a generally rising stock market. But two wayward columns stick out. Although I had outlined the dangers of software maker Symantec's stated plan to grow through acquisitions, I never figured its later deal for Veritas Software would slay the stock as it did, even as its cash flow kept growing. And finally, there was my old friend Krispy Kreme Doughnuts. Back in 2000, when Krispy Kreme was a puffed up, I was too early in warning of a top; in 2004, when it had deflated, I spied a bottom much too early. Despite the company's suspect accounting for acquisitions, I had thought investors could take comfort in operating cash flows. Yet the stock plunged even as that cash flow itself became questionable. The next time I get the urge to ponder pastry, I'll be off to Dunkin' Donuts, a privately held company that serves a tasty cup of coffee.

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JAMES C. COOPER

The Export Engine Is Shifting Into High Gear

Demand abroad is strengthening, while the dollar is poised to drop

U.S. ECONOMY The global economy promises to look a little less lopsided in 2006—much to the benefit of U.S. exporters. In the past few years, the U.S. has been the dominant force behind world growth. True, China and much of Asia have posted strong gains, but those markets are not as important to export businesses as those in the euro

zone and Japan. Those two areas account for more than 40% of all U.S. shipments abroad, but they have been lagging on life support in recent years.

The coming year will be a different story. While growth in the U.S. is expected to slow a notch, as higher interest rates begin to cool off housing and consumer spending, demand in both the euro zone and Japan will strengthen. Both regions are already showing signs that exceptionally low interest rates are finally shoring up labor markets and boosting domestic spending—even in growth laggard Germany. Outlays by Japanese consumers and businesses are picking up steam now that Japan is winning its battle with deflation and stagnation.

The economies of both Canada and Mexico, which absorb more than a third of U.S. exports, are expected to show some improvement as well. Growth in China may wobble a bit, but it will remain robust enough to keep Asian growth powering ahead at a solid clip (table).

Stronger foreign demand may not be the only plus for exporters this year. There are good reasons to believe that the dollar is ready to start declining again, especially against the euro and the yen, after the greenback's surprising strength during most of 2005.

That's because improving growth prospects abroad and rising foreign interest rates will enhance the potential return on overseas investments relative to dollar-based opportunities in the U.S. The dollar dropped sharply vs. the euro on Jan. 3-4, after the minutes of the Federal Reserve's Dec. 13 meeting suggested that the Fed's rate hiking may end soon.

THE REAL WINNER in this scenario is U.S. manufacturing. The industrial sector has shown new strength in recent months in response to resilient domestic demand by U.S. consumers and businesses. The December purchasing managers' index of industrial activity slipped almost four points from November, to 54.2%, but that decline was from a high level exaggerated by the post-hurricane rebound, and the December reading is consistent with a strong factory sector. Although the purchasers' index of export orders dipped in December, its average for the entire quarter increased for the second quarter in a row.

In 2006 manufacturers can expect an additional lift from overseas, especially makers of capital goods. Exports of business equipment, ranging from aircraft to high-tech gear, have accounted for more than 85% of the U.S. goods exported during the past year.

Exports in 2005 slowed from their strong performance in the previous year, as surging energy costs ate into

global demand and the broad trade-weighted dollar rose. Not all the data for 2005 are in yet, but exports are on track to grow a couple of percentage points less than in 2004. In that year, foreign shipments of goods and services increased 8.4%, their best showing in four years, helped by the 16% decline in the broad trade-weighted dollar

A LITTLE MORE BALANCE IN GLOBAL GROWTH

REAL GDP GROWTH FORECASTS

	ANNUAL PERCENT CHANGE	
	2005	2006
BRITAIN	1.8	2.2
CANADA	2.9	3.0
CHINA	9.4	8.5
EUROZONE	1.3	1.8
JAPAN	2.2	1.9
MEXICO	3.2	3.4
SOUTH KOREA	3.7	4.5
U.S.	3.6	3.4

Data: Consensus projections, Blue Chip Economic Indicators

between early 2002 and late 2004.

This year, U.S. exports stand a good chance to post their strongest growth since their last double-digit performance—in 1997. Stronger overseas demand will help, but greater competitiveness in foreign markets because of a cheaper dollar will also be a key factor in achieving that result.

That's especially true for the dollar vs. the yen and the euro, which is where the greenback gained the most ground in 2005. Using the inflation-adjusted indexes calculated by the Federal Reserve, the broadest measure of the trade-weighted dollar rose 4% last year. However, it soared more than 10% vs. major currencies, which the Fed defines as the euro, yen, British pound, Swiss franc, Swedish krona, and the Canadian and Australian dollars. In particular, the dollar gained 12.5% against the euro and 14.8% vs. the yen.

THE GOOD NEWS: Those two currencies are the ones against which the dollar will likely lose the most altitude this year. One reason is that the Federal Reserve appears

very close to ending its interest-rate hiking. But at the same time, the European Central Bank has only now begun to lift rates, and the Bank of Japan is discussing when to end its four-year policy of zero rates. A narrowing in the rate differences between these two regions and the U.S. will make prospective returns on dollar-based securities relatively less attractive to investors. That's the opposite of the trend in 2005.

Another reason: Growth in the U.S. economy in 2005, which is expected to wind up at 3.6% when all the data are in, far outpaced the 1.3% and 2.2% clips expected for the euro zone and Japan, respectively. In 2006, those growth differences should narrow, another relative minus for investors' perceptions of dollar-based returns.

INTERESTINGLY, THE DOLLAR'S broad rise last year disguised one surprising trend in U.S. competitiveness that seems likely to continue this year. While the dollar was strengthening against the currencies of the U.S.'s major trading partners, it was actually slipping against those of other smaller, but important, partners (chart).

The Fed also calculates a separate trade-weighted dollar index, made up of 19 "other important trading partners." Those 19 include China and Asian economies, key Latin American nations, and other countries that all together make up about 40% of U.S. trade volumes.

Since the middle of 2004, the dollar has declined more than 6% vs. this basket of currencies. Many of these nations keep their currencies in a tight range relative to the dollar. China's baby-step revaluation of its yuan last

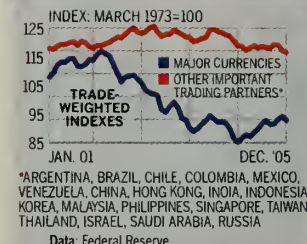
July, which lifted its value vs. the dollar by about 2%, was partly responsible for this trend, but the benefits to U.S. exporters have been broader. For example, overall export to Pacific Rim countries, excluding Japan, in October were up nearly 14% from a year ago.

Following China's lead in its move toward more

currency flexibility, other Asian nations have also relaxed their hold on the currencies. Plus, by the end of 2005, the Chinese yuan appears to have appreciated further, based on its movement against a basket of currencies. Economists expect to see a further rise in the coming year.

Nevertheless, while exports are set to make

WHERE THE DOLLAR HAS RISEN—AND FALLEN



headway in 2006, don't expect those gains to narrow the gaping U.S. trade deficit. Even if exports grow by 10%, adjusting for inflation, import growth would have to be limited to about 6.5% just to hold the trade deficit at its current level. Unless the slowing in U.S. demand is much greater than now expected, imports will most likely grow faster than that pace. That means trade patterns will not be universally positive for U.S. manufacturers. For exporters, however, 2006 is shaping up to be a very good year. ■

—With James Mehring in New York

CORPORATE FORECAST

Capital Spending: Ready to Accelerate

EVER SINCE the recession ended four years ago, American businesses have shown unprecedented caution in shelling out money for new equipment, buildings, and even inventories. That past caution, however, is now a key factor in the upbeat outlook for capital spending.

Against a dearth of past investment, many businesses, especially in the industrial sector, lack the production capacity to meet current demand, which has been surprisingly resilient both at home and abroad. Among nonfinancial corporations, for example, capital spending as a share of gross domestic product stood at only 13.9% in the third

quarter of 2005. That is well below the long-run average of 15.7%, and far below the peaks reached in the 1980s and '90s (chart).

Recent trends in the industrial sector illustrate why that figure is almost certain to jump in 2006. Industrial output is growing faster than the rate at which companies are adding to their production capacity. Through November, output had

grown 2.8%, while capacity was up only 1.6%. That disparity is likely to widen. From most recent signs, industrial production is accelerating.

As a result, the average operating rate rose sharply last year, reaching 80.3% prior to Hurricane Katrina, the highest in nearly five years. Faster

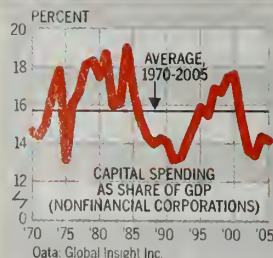
output is sure to keep utilization rising in 2006, adding pressure on companies to buy new equipment and beef up inventories. Businesses also will face the need to replace worn-out computers and tech gear in order to maintain productivity gains.

Companies will be putting up new buildings at a faster rate as well. Industrial vacancy rates are falling and the American Institute of Architects' Architecture Billings Index, which foreshadows business construction trends about six months ahead, is rising. The AIA says the November increase implies that 2006 could be the best year for nonresidential building since 2000.

Companies are forced to shed their caution at a time when their outlays will offset the expected slowdown in housing and consumer demand. Having a ton of cash on hand will help businesses to feel bolder. ■

—With James Mehring in New York

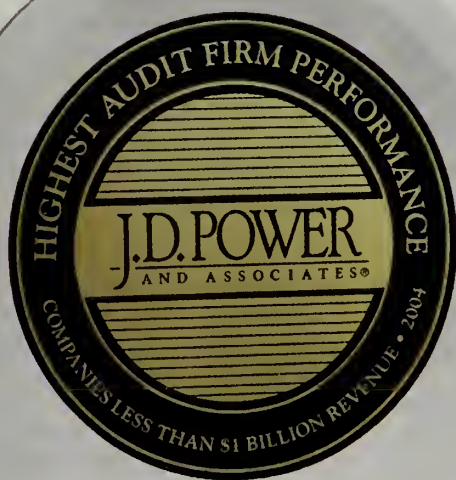
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EDITED BY HARRY MAURER



Gazprom's Big Squeeze Happy New Year. And oh, by the way, we're shutting off your natural gas. So said Russia's gargantuan Gazprom to **Ukraine** on Jan. 1, sending midwinter shivers across Europe and the global energy business. Gazprom wanted to nearly quintuple the price Ukraine pays for gas, bringing it closer to market levels. But the partial cutoff also immediately hit **Western Europe**, which buys 25% of its gas from Russia, much of it delivered via pipelines that cross Ukraine.

It may not have been the **Kremlin's** smartest hour. Gazprom's move seemed designed to punish Ukraine for the **Orange Revolution** of 2004-05 and a turn toward the West under **President Viktor Yushchenko**. This use of state-owned Gazprom as a blunt instrument of policy alarmed its customers and could speed their search for more trustworthy suppliers. That's probably why the bear backed off growling after a day, turned most of the gas on, and struck a deal on Jan. 4 that looked sweet for Ukraine.

See "This gas dispute could burn Russia," www.businessweek.com/go/tbw

Fall of a Fixer Jack Abramoff, the lobbyist with the golden touch, pleaded guilty to federal charges of conspiracy, mail fraud, and tax evasion on Jan. 3 and agreed to cooperate with prosecutors studying his links with members of Congress. The fast-spreading scandal and likely reforms will make **K Street** a lot less like Easy Street for Big Business' hired hands.

See "Business feels a chill on the Hill," page 32

BASF Goes After Engelhard Management of Iseli (N.J.)-based Engelhard showed little enthusiasm for a \$4.4 billion unsolicited takeover offer from German chemical giant BASF, but shareholders have plenty of reason to po open any bubbly left over from New Year's Eve. Shares in Engelhard, best known for its automotive catalytic converters, shot up \$7.85, to \$38, following the offer. Given that the stock has been stuck around \$30 for two years, it will be tough for Engelhard to argue that it's worth a lot more than the \$37 BASF has put on the table.

See "Germany flexes some new muscle" www.businessweek.com/go/tbw

The Fed Watch We're not sure. That uncertain message from the **Federal Reserve** stoked Wall Street on Jan. 3, sending the Dow up 1.2%. The minutes from the Fed's Dec. 13 meeting said that the number of rate hikes needed to complete the current round of tightening "probably would not be large." But more important, the minutes revealed, future hikes would depend increasingly on economic data. Trade read those tea leaves to mean the overnight funds rate, now at 4.25%, isn't fated to rise to 5%. Instead the Fed may go to 4.5% and stop there if the economy isn't overly frisky.

Hilton Buys Hilton Way back in 1964, when **Hilton Hotels** spun off its international inns, it agreed not to open a hotel outside North America. Forty-one years later it said goodbye to all that, buying back the hotel unit of **British Hilton Group** on Dec. 29 for \$5.7 billion. That will allow Hilton to follow rivals into fast-growth realms overseas. Bond markets put out the not-welcome mat for the deal, which will lift Hilton's debt from \$2.5 billion to \$8 billion.

China's Numbers The Middle Kingdom's economy keeps growing—and growing faster—as if by magic. In December, Beijing's statistics agency released a survey that ferreted out billions of dollars in unreported output, mostly from small, private, service outfits such as restaurants and travel agencies. Then, on Jan. 1, **Xinhua News Agency** said the economy clocked 9.8% growth in 2005—up from estimates of 9.4%. The reason was the same: hitherto overlooked services. Pass the hidden dumplings, please.

See "A new window on China's growth" www.businessweek.com/go/tbw

A CEO for Aetna John Rowe will turn over the corner office to operations czar **Ronald Williams** in February. The pair have transformed the insurer from a train wreck into a sleek machine since 2001.

See "Aetna: A succession at full speed," page 32

Big Oil in Libya Muammar Qaddafi agreed to a \$2.7 billion settlement over the 1989 bombing of **Pan Am Flight 103** because he wanted trade and investment. Now the American oil companies that made up **Oasis Group** are coming back. **Amerada Hess**, **ConocoPhillips**, and **Marathon** will fork

\$3 billion to regain their concession, plus \$530 million for investments made since their 1986 exit. They're expected to boost output, which has fallen from about 1 million barrels per day to 350,000.

Airlines Up and Down The airline industry is finally getting serious about dropping excess baggage. After more than three years in Chapter 11, **United** won creditors' O.K. to emerge next month as a trimmer and maybe even profitable company. Another bankrupt carrier, **Delta**, saw its pilots approve an 18% wage cut as it tries to copy United. The No. 2 and 13 airlines should also catch a break with the Jan. 5 shutdown of upstart **Independence**, which had tried to take them from Washington Dulles International Airport.

Citi Coup? Citigroup came late to China but may be making up for lost time. On Dec. 30, Reuters reported that a group Citi leads will win the right to negotiate with **Guangdong Development Bank** for an 85% stake. The deal would mark the first foreign takeover of a state-owned bank. At \$3 billion, Citi would be paying a fancy premium for a woeful bank but would jump ahead of foreign rivals.

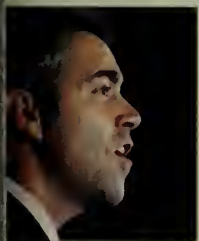
The SEC Talks Tough Companies that were hoping for a pass from **Christopher Cox's** SEC got a jolt on Jan. 4. The Republican chairman issued new standards for corporate penalties, rejecting the line taken by many conservatives that such fines only harm shareholders. The securities laws will come down hard when fraud directly benefits a company, and when the chance to repay ex-shareholders by fraud outweighs the harm done to current owners.

Shuffle of the Week

The major media guessing game concluded on Jan. 3 when **Dow Jones** said that **CEO Peter Kann** would be replaced on Feb. 1 by **COO Richard Zannino**. (Kann will remain chairman until 2007's annual meeting.) Also leaving, after an unspecified transition period: **Karen Elliott House**,

Wall Street Journal publisher and Kann's wife. Thus ends the long and loud grousing—both external and internal—over Kann's and House's management, as well as endless angst over the succession. Zannino, who has been in the media business only since 2001, will move fast to blend print and online at the *Journal* and centralize them under one boss. Lead dog in that

hunt is **Gordon Crovitz**, head of electronic publishing. On Jan. 3, Dow Jones announced a brighter earnings outlook, but it's unclear how much of the stock's 10% jump that day was due to the Street's applause over the changes. Look now for the who-will-buy-Dow-Jones chatter to die down—if only for a while—as Zannino gets his shot.



RICHARD ZANNINO



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News Analysis & Commentary



STORMS

THE WORST ISN'T OVER

Smarter science is helping companies and insurers plan for hurricanes. The bad news: This year could be another doozy

BY ADAM ASTON

AL DIAZ/MIAMI HERALD/WPN

AS THE U.S. RANG IN THE NEW YEAR, tropical storm Zeta was still out there. A month after the official end of 2005's record-shattering hurricane season, the year's last tropical storm continued to churn the dark mid-Atlantic into a frenzy with 65-mile-per-hour winds. Consider Zeta an omen. Just when anxious coastal residents, climate experts, and harried insurance executives might like to settle down for a winter rest, the first forecasts for the 2006 storm season are in, and it looks like another bad one. "This year's theme: Get used to it," says Andrew Castaldi, head of catastrophe and perils at Swiss Re. In December weather scientists cautiously scoped out the year ahead in order to help nervous businesses start to prepare. The stakes are high. Last season left property and casualty insurers facing a record \$80 billion in property losses, on top of \$45 billion in 2004, the previous worst year. It's no surprise, then, that big insurers and companies such as Gap Inc. and Charles Schwab Corp. increasingly use weather and risk models to guide strategic decisions about what to insure, for how much, and even where to site operations. Meteorologists at both University College London and Colorado State University expect about 16 tropical storms in the Atlantic this year, including about nine hurricanes, of which four or five will be major storms of category 3, 4, or 5. Two hurricanes are

likely to strike the U.S. coast, predicts Mark Saunders, professor of climate prediction at University College London and lead scientist at TropicalStormRisk.com (TSR).

Hurricane prediction, admittedly, is nearly as much an art as a science—especially this early in the year. Yet forecasting has improved enormously since 1992, when Andrew did \$26.5 billion in damage, ending a period of relative calm. In the decade since, scientists have acquired better sensing technology, more advanced numerical weather-prediction systems, and an increasingly sophisticated take on how storms form.

Today's hurricane specialists can also crunch through an unprecedented volume of weather data. With about 150 years of storm-tracking information at their disposal, they have concluded that hurricane frequency and intensity rise and fall in 20-to-30-year cycles. Within that rhythm, scientists also watch secondary signals that can alter year-to-year forecasts. The coming season is likely to see a mild cooling in

the equatorial Pacific—called *La Niña*—that correlates with increased Atlantic storm activity, says Gerry Bell, lead seasonal hurricane forecaster at the National Oceanic & Atmospheric Administration (NOAA). Recently rising sea surface temperatures in the mid-Atlantic and Gulf of

fer another clue that it will be an active year.

New data sources are helping to push the frontiers of hurricane theory further. A constellation of earth-orbiting satellites records everything from storm position to water temperature many times every hour. Planes crisscross storms as they form and grow, taking detailed measurements at multiple positions

over weeks at a stretch. En route, they scatter parachute-borne sensor packages, explains Naomi Surgi, NOAA's hurricane modeling leader. These sacrificial machines fall through the storm, relaying back data on humidity, temperature, wind speed, and other vital statistics. "What used to take me years to gather can be downloaded in a few min-

utes," says Bill Gray, an emeritus professor of atmospheric science at Colorado State and co-author of a closely watched forecast, who started chasing hurricanes in 1953.

DECADES OF DATA

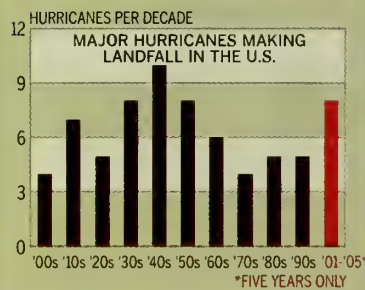
STILL, THE LONG-TERM models remain unspecific about critical variables, including where the storms will actually travel. Global warming is another wrench in the works. Climatologists concur that because of the ocean drives hurricanes, they cannot agree about how much it changes the annual outlook. And it's not clear whether rising sea temperatures are part of a longer cycle or if they are caused or aggravated by man-made pollution.

Getting a bead on approaching storm seasons is critical to insurers, which then adjust their rates, capital reserves and decisions about what to insure based on storm forecasts for the coming year. A small group of specialized catastrophe risk modelers are helping big insurers and property owners do just that. If hurricane scientists make programs that simulate sea and sky, "cat-risk" specialists focus on models of the earth and buildings where humans live and work.

The top cat-risk modelers—Boston's AIR Worldwide, London-based EQE International, and Risk Management Solutions in Newark, Calif.—are closely

SLAMMING ASHORE

If hurricanes follow a 30-year cycle, we are in for heavier weather



INSURANCE

How Hedge Funds Are Taking On Mother Nature

If 2006 is a quiet year for hurricanes, Greg Hagood stands to make a ton of money. But if more Katrina-size storms rip into the U.S., he and the investors in the hedge fund group he co-manages, Bermuda-based Nephila Capital Ltd., could get their shingles blown off.

That's a gamble Hagood and other hedge-fund managers are happy to make. Awash in capital, hedge funds hope to cash in on catastrophe insurance, whose price has zoomed since Katrina wreaked \$38 billion in insured losses. They don't sell policies to companies or homeowners. Instead, they absorb some of the risk of future megadisasters from shell-shocked insurers.

The infusion of money from hedge funds,

as well as from other sources, is helping to keep catastrophe coverage available, while preventing rates—which in some cases have more than doubled—from going even higher. By contrast, after Hurricane Andrew devastated a chunk of South Florida in 1992, fresh capital was scarce at first, sending commercial rates soaring and putting pressure on the homeowner market. Some household insurers even pulled out of Florida after the state blocked them from raising rates sufficiently.

This time, hedge funds are changing the dynamics. True, they still account for a relatively small fraction of total catastrophe protection; estimates range from 1% to around 10%. And hedge funds supplied less

than half of the \$9 billion raised by reinsurers since Sept. 1. Nephila, for instance, has 12 dozen employees. (It's named after the mythical spider that, according to Bermudian folklore, can sense approaching hurricanes.)

Collectively, though, hedge funds have huge sums available for catastrophe protection. That means much more hedge money is likely to flood in if rates remain high. Among the funds that have already entered the sector are Kenneth C. Griffin's Citadel Investment Group in Chicago, Charles W. Smith's Soros Fund Management, HKB Investments in Dallas, and Louis M. Bachelier's Moore Capital Management.

For insurers, the hardest risks to price are the greatest disasters, because there's little experience to draw on. That's where hedge funds, with their appetite for risk, are making the biggest difference, says Albert J. Pinson, senior partner in the law firm of Moulton, Wollan & Greengrass in New York, who works with hedge funds. Last year a pioneering fund committed itself to pay one insurer \$1 million in the seemingly unlikely event of hurricanes in one season each costing \$1

Work in Progress

Predicting hurricanes and their impact is an imperfect science, but it's getting better. Here's why:

MODELS

Risk experts combine hurricane forecasts with detailed models of the built world—right down to the elevation of individual buildings—helping to fine-tune decisions about financial exposure to storms.

DATA

From buoys that measure sea surface conditions to satellites that track storms, a growing number of sensors are delivering more detail about the earth's complex weather.

THEORY

The data stream helps scientists grasp the interplay among weather signals, such as how warm oceans fuel hurricanes, how La Niña can heighten storm activity, and how such factors fit into 20-to-30-year storm cycles.

Bank tanks staffed with teams of economists and scientists. Their esoteric specialties range from soil dynamics to wild modeling. Models they spin out delineate a range of possible losses in the coming year for insurers and big firms such as Gap and Staples, says Bruce Norris, a senior vice-president at commercial insurance broker Hilb Rogal & Hobbs Co. Schwab even uses the data to help site its backup offices in low-risk areas, he adds. J.C. Penney Co. does likewise. After it picks a new store site based on demographic factors, the company's

insurers provide local catastrophe risk estimates. In sites where bad weather is likely, Penney ruggedizes its facilities beyond local codes. Its reward? Lower insurance premiums.

MORE REALISM

THE CAT-RISK MODELERS' raw ore is decades' worth of insurance returns filed after big disasters hit. After a hurricane, for example, these records capture the nature and severity of wind and flood damage, as well as repair costs across thousands of buildings. "Each hurricane is

like a laboratory to fine tune our model" of how damage is done, says Robert Muir-Wood, chief research officer at Risk Management Solutions.

Every new catastrophe enriches the data. Studying hundreds of storms and running hundreds of thousands of scenarios based on different storm intensities, modelers can generate "catalogs"—a statistical distribution—of losses insurers could face under different outcomes, from a year of no landfalling storms to a record year like 2005. For cat-risk experts, hurricane forecasts—like those from Colorado State and TSR—are among the first variables they feed into the model to produce the next year's loss estimates.

Meanwhile, cat-risk models are also getting more realistic. While past analyses didn't differentiate among blocks of houses, the latest software aims to give each home its own real-world attributes. GPS coordinates, along with building records, can help distinguish a low-lying wood-frame house from a brick one on high ground and adjust damage estimates accordingly. "We're putting more real-world physics into the models," says Jayanta Guin, vice-president for research and modeling at AIR. The new tools won't prevent catastrophic losses, but they put companies in a stronger position to prepare for them. ■

—With Joseph Weber in Chicago

try \$10 billion or more, according to Enda McDonnell, CEO of Access Reinsurance Inc. in New York, N.J., who brokered the deal. The premium for the policy was \$600,000. But the payout was almost triggered in 2005, when the premium had soared to \$1.5 million. The increase might have been even bigger

without the added participation of hedge funds, McDonnell says.

It's still not clear whether catastrophe insurance is a good deal for hedge funds. On the plus side, it's a new basket for them to put some of their eggs in, since the returns from the sector are uncorrelated with those

of stocks, bonds, or other assets. And by moving into an area of high risk, they can make good returns.

The big danger, of course, is that Mother Nature will be nastier than the funds expect. The problem with catastrophe reinsurance is that you don't discover until it's too late that

you've underpriced it, says James Ellman, president of hedge fund Seacliff Capital, which has avoided the sector. Even Nephila's Hagood says that for hedge funds that lack underwriting expertise, the pricing is "extremely opaque."

Is betting against hurricanes risky? Sure. But if hedge funds want to take the chance, insurance companies and businesses that need insurance are happy to let them ante up.

—By Peter Coy

Three Ways to Ride Out a Storm

Hurricane Katrina wiped out more insurance capital than any disaster before. But businesses and families can still buy coverage. One reason: huge inflow of capital, some of it from hedge funds. Here's how the strategies are gambling against natural disaster:

INDUSTRY LOSS WARRANTY For a price, the hedge fund promises to pay an insurer a set sum—say, \$100 million—if a storm is sufficiently destructive, regardless of the insurer's actual losses.

CATASTROPHE BOND The hedge fund buys a bond issued by an insurer that pays an attractive rate. The insurer doesn't have to repay the bond if a big enough storm hits.

REINSURANCE The hedge fund invests in a traditional reinsurance company or launches its own. Reinsurers provide insurance to insurance companies.



Data: BusinessWeek

PHOTOGRAPH BY NOAA/GETTY IMAGES; ILLUSTRATION BY ALEX NABAUM



ABRAMOFF (center)
He could face \$26.7 million
in restitution costs

INFLUENCE-PEDDLING

BUSINESS FEELS A CHILL ON THE HILL

The fall of a superlobbyist will likely lead to tougher rules on lobbying Congress

BY EAMON JAVERS

AS FALLEN SUPERLOBBYIST Jack Abramoff hunched his shoulders and walked out of a federal courthouse just blocks from the Capitol on Jan. 3, the frenzied era of no-holds-barred money politics he helped build and exploit for his own ends may have slouched out with him.

For Abramoff, once one of the most powerful unseen players in GOP politics, a guilty plea to federal charges of conspiracy, mail fraud, and tax evasion could cost him a decade behind bars and \$26.7 million in restitution. For dozens of lawmakers who received campaign cash or favors from the lobbyist, his pleas mean a stomach-churning wait to learn what he'll spill to prosecutors probing capital corruption.

But for the business community, Abramoff's spectacular fall from grace will make 2006 a year of backlash against the culture of influence-peddling. The almost certain results: new laws to govern lobbying in Washington and a rapidly chilling climate for business' representatives on K Street. "CEOs will want to call in their lobbyists and ask a lot more questions about what they're doing in Washington," says Republican lobbyist Scott Reed. "Jack Abramoff brought a microscope to the whole industry."

Even before Abramoff copped a plea, the push for reform had been gaining momentum. Congress is mulling three major proposals to tighten regulations on lobbyists and the companies that hire them. The one with the most support was unveiled in December by Senator John McCain (R-Ariz.), author of the bipartisan campaign-finance law that bears his name. McCain would double the maximum penalty for filing a false or incomplete lobbying disclosure form, to \$100,000. He would require lobbyists to reveal all gifts to lawmakers or staffers worth \$20 or more, itemize all fund-raisers they host, and file electronic disclo-

Curbing K Street

A proposal by Senator John McCain to clamp down on lobbying is gaining support. These three requirements would make it stronger:

DISCLOSE ALL FEES Lobbyists should report income from consulting, grassroots organizing, and PR work that they do for special interests.

REPORT WHO'S GIVING TO CHARITIES Lawmakers and lobbyists now use tax-exempt charities to shuttle money back and forth without disclosing the source of funds.

MAKE GIFTS TO LAWMAKERS ILLEGAL The rule banning gifts worth more than \$50 is rarely enforced. A tighter cap written into law would trigger criminal penalties.

asures of new clients almost immediately. McCain would also close a loophole by requiring so-called grassroots firms register as lobbyists. These firms hired to rally support among a lawmaker's constituents for a specific issue. "We must act now to ensure that the erosion we see today in the public's confidence in Congress does not become a collapse of confidence," McCain said when he introduced the bill.

DIALING BACK

FACING SKEPTICAL voters in November, lawmakers are likely to act. "They'll want to do something to show that they are doing something," says University of Virginia political scientist Larry J. Sabato. "They'll want to demonstrate that they are independent of Abramoff." But McCain's proposals strike many lobbying critics as weak—and could end up as just the starting point. Democrats, sensing a political opening in an election year, are pushing to outlaw junkets organized by lobbyists. They would also require members of Congress, senior staff, and executive branch officials to disclose when they're negotiating for jobs in the private sector.

House GOP leaders, meanwhile, likely to co-opt the issue with measures that would rein in the tax-exempt 527 committees that raised millions to oppose George W. Bush's reelection in 2004.

So what should the careful chief executive do now? One senior Hill staffer says that companies doing business in Washington should go beyond the letter of the law, double-checking all gifts and entertainment that they offer lawmakers or

staffs. Smart lobbyists also dial back their involvement in legislative language favors clients.

Of course, money going to vanish from the books. But business now has to be a lot more cautious about spreading around its largesse. A line between gift and graft becomes clearer when that line is crossed and will get higher. ■

—With Richard Dunham in Washington

Data: BusinessWeek

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PORSCHE

INVESTIGATIONS

IS THIS DENTAL DIAGNOSIS REAL?

A radical treatment prompts a lawsuit by Aetna—and raises questions for the FDA

BY ARLENE WEINTRAUB
AND AMY BARRETT

IT HAS BEEN SIX YEARS SINCE A pair of dentists talked Mirjana Lukic into having 13 teeth and a lot of her jaw removed. Lukic, who lives in Escondido, Calif., says the dentists recommended the treatment to relieve her headaches and warned, “if I didn’t remove the teeth, I’d get cancer and die.” But after the surgery, her headaches persisted, so she sued the dentists, Dr. James Shen and Dr. Rily Young of Huntington Beach, Calif. The case was settled confidentially in 2003.

Lukic questions the legitimacy of Shen’s and Young’s diagnosis: neuralgia inducing cavitation osteonecrosis (NICO). The small band of dentists who make the controversial NICO diagnosis say the condition is characterized by infected lesions in the jaw. They often advise patients to remove most or all of their teeth and parts of their jaws. A lawyer for dentists Shen and Young declined to comment.

Now, Aetna Inc. and some dental experts are arguing that the NICO diagnosis is bogus. The giant insurer is waging a legal fight against Cavitat Medical Technologies Inc., the Emory (Tex.) manufacturer of a scanning machine used in some NICO diagnoses, and the company owner, Robert J. Jones. In a suit brought in federal court in Denver, Aetna alleges that during the past six years, Cavitat and Jones, along with Shen and more than a dozen other dentists, deceived

Aetna into paying out at least 400 claims for services related to NICO by using inaccurate diagnosis codes. Aetna’s alleged losses could total millions of dollars.

PAIN THEORY

THE STRANGE STORY behind the Cavitat machine and how it got onto the market illustrates serious flaws in the Food & Drug Administration’s device-clearance process. And Aetna’s allegations raise questions about whether automation of the claims process has left insurers vulnerable to fraud.

According to the American Dental

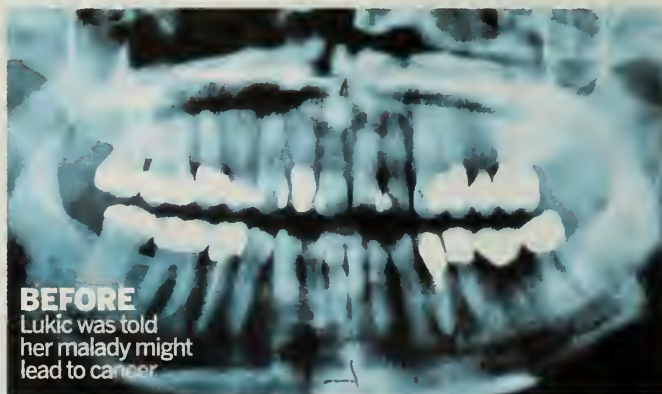


LUKIC sued dentists after the headaches returned

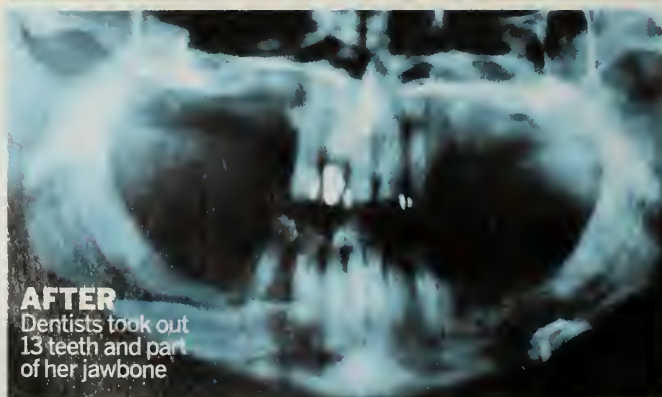
Assn., NICO started appearing in dental literature around 1979. The theory is that poor blood flow can damage bones and marrow in the jaw. NICO believers say that such damage can trigger pain as far afield as the heart. But the ADA hasn’t endorsed the NICO diagnosis, and the Cavitat machine failed to earn its Seal of Acceptance.

Dentists who diagnose NICO often remove suspect teeth and bone and send them to laboratories to confirm the disease. To critics such as Robert Baratz, a dentist and physician at Quincy Medical Center in Boston, this seems absurd. “A biopsy is not going out a quarter of someone’s jawbone,” he says. “That’s assault and battery.”

Don’t tell that to Cavitat Jones. A former airline pilot, he was once diagnosed with a bone disease that he says kept him in a wheelchair. A dentist told him the problem was in his jaw. “He removed all teeth and cleaned the jaw out,” Jones recounts in a recent interview. “I’m walking again. I’m well for the first time in years.” Jones says he invented the Cavitat machine in the early 1990s to detect problems such as his own. He describes the machine as a “sonar imaging device” that produces three-dimensional



BEFORE
Lukic was told her malady might lead to cancer.



AFTER
Dentists took out 13 teeth and part of her jawbone

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graphs showing pores in the bone. Jones adds he has sold about 100 of them at \$28,000 apiece.

Cavitat's Web site markets the device as "an aid" in diagnosing NICO and other jaw conditions. The company has sponsored several conferences, where dentists such as Dr. Wesley E. Shankland give presentations. According to Aetna's suit, Shankland once boasted to attendees at such a conference that "Stevie Wonder could use those things and make money." Shankland declined to comment on statements attributed to him. He said his talks were about diagnosing disorders, not specifically about using the Cavitat machine.

By making any references to NICO at all, though, Cavitat may be overstepping its FDA approval. In February, 2002, the machine was cleared for marketing under a process called a 510(k). This route typically allows manufacturers to market devices without doing extensive clinical trials, provided the devices aren't critical life-sustaining products. All they need to do is prove their products are essentially equivalent to another device on the market. Cavitat's clearance letter stated that it could be used only in conjunction with other methods of diagnosing disease. Marketing it as a stand-alone tool for detecting NICO would constitute off-label promotion, Aetna contends in its suit—something no manufacturer is permitted to do under FDA rules. The FDA "rejected any mention of NICO," recalls Larry R. Pilot, a lawyer who represented Cavitat in 2002. Says Jones: "We never claim we image NICO. We image bone. That was cleared by the FDA."

Making the complexities of 510(k) even murkier is the fact that the FDA sometimes appears to second-guess its decisions. On Sept. 5, 2003, it sent Jones a warning letter describing three violations related to two clinical studies that Cavitat submitted during the clearance process. The studies were conducted by Dr. Jerry Bouquot, who coined the term NICO and is now a professor of dentistry at the University of Texas's dental branch at Houston. But 20 days later, the agency sent another letter, this time to Bouquot, saying an inspection "revealed no significant deviations from FDA regulations." In an interview, Bouquot says that he spent a day with the investigators answering ques-



AT ODDS Baratz (above) calls the NICO procedure "assault and battery." Cavitat CEO Jones says because of it, "I'm well for the first time in 14 years"



tions about how the Cavitat scans were interpreted in the studies, as well as about his relationship with Cavitat. "They didn't find anything wrong here," he says, adding that "I never accepted a penny for any reason whatsoever from Cavitat." In an e-mail to *BusinessWeek*, the FDA said only: "This case is closed. The firm adequately responded to the cites in the warning letter."

Some experts say the 510(k) process is flawed because the FDA relies on manufacturers to determine whether new devices are similar to earlier ones, and companies tend to provide minimal in-

formation backing up those claims. "It's easy to manipulate the system to get into the market," says Dr. Suzanne Parisian, a consultant and former chief medical officer at the FDA's Center for Devices & Radiological Health. Marjorie G. Shulman, consumer safety officer at the Office of Device Evaluation at the FDA, says the 510(k) system is adequate. The agency carefully inspects manufacturers and evaluates their data, she adds.

The abbreviated 510(k) approval process may explain why some devices have run into trouble. In 2001, St. Jude Medical in St. Paul, Minn., received 510(k) clearance to market a connector that could be used in place of sutures during heart bypass surgery. But one research paper subsequently warned about a potentially high rate of complications. St. Jude continued the product in 2004, saying in a press release that the market was weak because of a drop in surgeries. St. Jude was hit with more than 20 lawsuits over the device, all but six of which it says it has "solved." It took a net charge of \$9 million to cover potential liabilities. A spokeswoman for St. Jude says: "The rate of complications seen in patients with the device was comparable to that of patients who sutures were used."

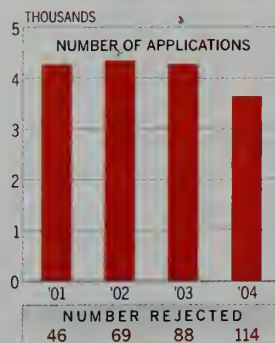
Fewer devices are getting through the 510(k) process lately, although the FDA declined to say why. In 2004, applications dropped 14%, to 3,635, while the number of applications turned down jumped 29.5%, to 114, according to the agency's Web site. The FDA cleared 3,460.

COURT DUEL

AETNA SAYS IT HAS discovered claims improperly filed for NICO treatment—none of which would have been to light had Cavitat not filed suit against the insurer. In September 2004, Cavitat alleged that Aetna interfered with its ability to do business by publishing an explanation why it won't pay for NICO treatments. "We intend to put Jones out of business," Jones says. John Shely, an outside lawyer for the insurer, counters "Aetna believes it is important

Faster Road to Market

Under the FDA's 510(k) shortcut to clearance, manufacturers can skip extensive clinical trials for devices that are essentially equivalent to those already on the market. The agency clears most of the applications it receives, but lately it has been rejecting a larger number of them, without explaining why.



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consumers, employers, and health-care professionals have information about what is covered, and Aetna is legally entitled to publish that information." When Aetna started investigating Cavitat's charges, it discovered the alleged wrongful claims and countersued.

The Aetna case blasts Cavitat customers such as Dr. Michael Margolis, a dentist in Mesa, Ariz., who has spoken at Cavitat seminars.

Aetna has paid out 429 claims it is now disputing

Aetna alleges that Margolis advocates that his patients prepare for surgery with "hydrocolon therapy," or what he crudely calls "a tube up the booty cleans things out." Margolis confirms this but says Aetna is taking his comments out of context. "If they don't want to pay for it, that's their business, but they don't have the right to tell me I can't do something," he says. The Arizona State Board of Dental Examiners disciplined Margolis in April, 2004, for recommending that a Cavitat-scanned patient have five teeth removed. Margolis is suing the board. "I didn't do anything wrong," he says.

Aetna ended up paying for the claims it's now disputing because, like most other large insurers, it has become almost completely automated. Dentists and physicians submit claims that describe procedures using numeric codes assigned by outside agencies such as the American Medical Assn. There are no specific codes for NICO-related procedures. Aetna alleges that Cavitat's Jones coached dentists on how to use codes that describe treatments similar to those advocated for NICO so they would fly through the computer systems undetected. "We published [existing] insurance codes," says Jones. "There's nothing illegal, no misrepresentation, no insurance fraud."

It's likely that other insurance companies have been paying for NICO, too. "If Aetna lost millions, the loss to the entire industry could be in the tens of millions," estimates Evelyn Ireland, executive director of the National Association of Dental Plans. "When we pay claims that are miscoded, premiums go up," Ireland adds. "It ends up costing the consumer."

—With Susann Rutledge in New York

CONSUMER FINANCE

HOLD THE PLASTIC

Bill Me Later may lure leery online shoppers

BY PETER BURROWS

A FRAID TO SHOP ON the Web because you don't want to give out your credit-card number? Don't fret. Now you can order from 230 e-commerce sites such as Walmart.com, eToys.com, and Continental.com without using plastic.

Bill Me Later, a payment system created by Timonium (Md.)-based I4 Commerce Inc., asks consumers for only two bits of information: their date of birth and the last four digits of their Social Security number. I4's software approves or denies transactions by scouring the information entered on the merchant's Web site and by checking with credit bureaus and other databases—all within four seconds. If the purchase is approved, the consumer gets an old-fashioned bill via snail mail or e-mail. Payment can then be made by check, electronic fund transfer, or other means.

Some million consumers have already used Bill Me Later. "The truth is that credit cards weren't designed to be used online," says I4's CEO Gary Marino, 49, who helped FirstUSA, now a unit of JPMorgan Chase & Co., vault from the 30th-largest issuer of Visa cards to No. 1 in three years. "The [credit-card] process is clunky and scary for a lot of people."

Marino says I4 could process \$1 billion worth of transactions in 2006. That's far below the \$6 billion in mer-

chant sales likely to be processed by PayPal, a subsidiary of online auctioneer eBay Inc., an electronic wallet into which consumers can put money to make online purchases. But I4, with its no-money-down approach, is the only other online-payment plan to gain traction in recent years.

NO-RISK OPTION

A KEY QUESTION is how fast I4 can convince harried e-tailing companies to let Bill Me Later at the top of their to-do list. So far, it's available at only 6% of the sites, says Forrester Research Inc. But so many merchants who use it say it's a no-brainer. For starters, I4 charges a fee of 1.5% on transactions, vs. 2% or more for Visa, MasterCard, and other leading credit cards—a significant savings for low-margin retailers. "We've always been concerned by the fees the credit-card companies charge," says Ken Penny, general manager of Continental.com, the airline e-commerce site.

More important than cost savings, these merchants, is the fact that Bill Me Later gives them no-risk access to a new group of customers. Almost a third of Web surfers refuse to use plastic online, says Forrester. Another plus is that I4 accepts all the credit risk, so the merchant isn't on the hook for bad debt. That's possible because Marino persuaded financial giant JPMorgan Chase to underwrite the debt.

Huge obstacles remain. PayPal is aggressively trying to sign up merchants, and search giant Google Inc. has signaled that it has plans of its own in the payment front.

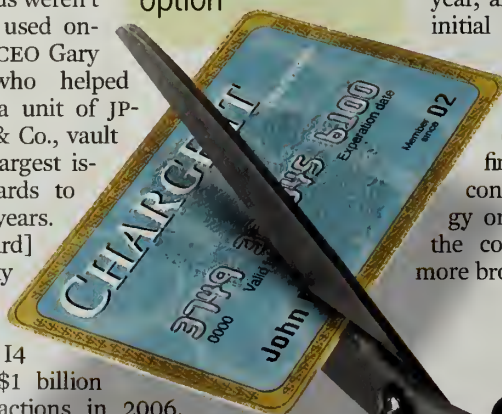
But Marino says he's on the right track. He expects I4 to achieve profitability in the third quarter of 2006, and insiders say an initial public offering is possible in 2007.

That is, unless a large credit company buys it first, either to control the technology or squelch it before the concept catches more broadly. ■

THE STAT

230

The number of online brands that offer Bill Me Later as a payment option



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MIXED SIGNALS

DON'T BE THROWN BY THE YIELD CURVE

This time around its inversion probably doesn't signal recession, but...

BY ROBEN FARZAD AND JUSTIN HIBBARD

THE WORDS "INVERTED yield curve" used to send Wall Street into a panic. In the normal state of affairs, the yields on longer-term Treasury bonds are greater than those on shorter-term Treasuries to compensate investors for taking on longer-term risk. When the curve inverts, the yield on short-term Treasuries is higher. This rare event—the last inversion was in 2000—has preceded the past six recessions.

But a funny thing happened when the yield curve reversed during the last week of December: Few people paid attention. Stocks dipped, but the sell-off was nothing that would indicate widespread recession fears.

Many economists say the latest inversion won't lead to recession because short-term interest rates are relatively low compared with past inversions, meaning consumers and businesses can still get credit at historically attractive terms. And some economists, including those at the Federal Reserve, argue that long-term yields have been artificially depressed by foreign investors, who have been buying longer-term Treasury bonds voraciously. Strip away the foreign buying, they say, and long-term rates would be far higher.

Don't bury the yield curve just yet, however. It might not be the harbinger of recession it once was, but changes in its slope still affect certain sectors. The latest inversion, say analysts, could hammer housing-related companies because home-loan costs are rising for some borrowers. The adjustable-rate mortgages (ARMs) that have fueled the booming coastal markets for three years are getting pricier as short-term rates jump. "The advantage of an ARM over a fixed-rate mort-

gage has largely been taken away given that the yields are [almost] equal," says Jim J. Fowler, an analyst at JMP Securities LLC in San Francisco. With ultra-low financing drying up, more buyers will be priced out of the housing market in 2006—bad news for homebuilders.

Some inversion cycles last only a few days. But with the Federal Reserve expected to raise the federal funds rate to 4.5% when it meets on Jan. 31, the current cycle could linger. Michael Moskowitz, president of New York-based mortgage bank Equity Now Inc., says an inversion that lasts four weeks or longer will hurt

mortgage lenders. Michael Benhamo, managing partner at Louis Capital Mar LP in New York, points to US Bancorp, Fannie Mae, and Freddie Mac as likely losers.

The downward curve isn't bad news for all corporate balance sheets. Producers of capital equipment should benefit from low long-term borrowing costs if economic growth continues at something near its current pace, many companies will increase capital expenditure financed with cheap credit. "We're expecting a solid year for equipment and software spending," says Michael Englund, chief economist at research firm Action Economics LLC. "Businesses seem to have very optimistic plans for investment in 2006."

REBUILDING REFINERIES

BIG COMPANIES THAT can tap public-debt markets rather than rely on bank loans should benefit most, says Yardeni of Oak Associates in Alexandria, Va. General Electric Co. is ideally suited, with access to the capital markets to fund its own growth and tons of capital equipment to sell to others, says Larry J. Pomeroy, manager of the T. Rowe Price Blue Chip Growth Fund. "It's at the head of the parade of the large caps that will do fairly well, most regardless of the economy."

Companies that sell equipment and services to the energy industry also stand to gain. Yardeni says that because of shrinking refining capacity caught up with U.S. oil and gas producers in 2005. Rebuilding refineries and energy distribution centers in the Gulf will account for some of the largest outlays this year, especially if long-term interest rates persist. Henry "Chip" Dickson, chief U.S. strategist at Lehman Brothers Inc., estimates that the sector will boost its capital spending 15% in 2006.

Another beneficiary of the flat-to-inverted yield curve are ordinary investors. According to Bankrate Inc., the one-year certificates of deposit offer an annual percentage yield of around 4.9%—just shy of the 5% you can get for a three-year CD, but without having to tie up your money for as long. After years of paltry short-term CD yields, 4.9% is pretty good. ■



Ups and Downs

The latest inversion may benefit some industries and hurt others

WINNERS

- Capital equipment
- Energy services

LOSERS

- Mortgage lenders
- Homebuilders

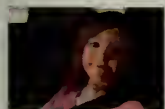
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ACE helps absorb frontal-collision energy.



Safety for Everyone. **HONDA**

The Power of Dreams

BY NANDINI LAKSHMAN

AFTER A YEAR ANSWERING phones for Swiss International Air Lines Ltd. in a Geneva call center, Myriam Vock was eager to see something of the world. So she packed her bags and hopped a plane to India. Two and a half years later she's still there, sharing a five-bedroom apartment in an upscale New Delhi suburb with four other foreigners.

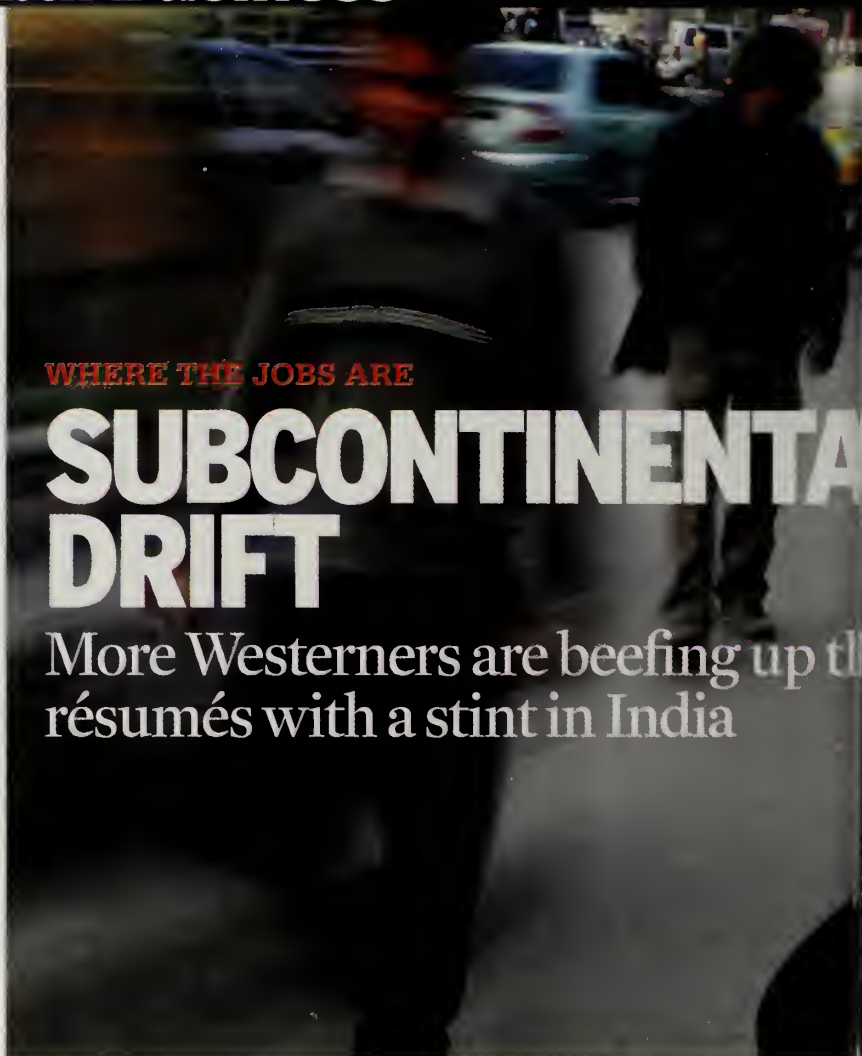
And how does she pay the bills? She works in a call center, getting paid a fraction of what she did back home. "I'm not earning much, but there is enough to live well and travel," says Vock, 21, who answers queries from French-speaking callers for Tecnovate eSolutions, a Delhi arm of London-based online travel agency eBookers PLC. "I don't pay taxes here, and life is so much cheaper," she says. For fun, she and her roommates take in a Bollywood flick a couple of times a week and cook at home or order in pizza when they tire of spicier Indian fare. She has already visited exotic spots such as the spiritual haven Hrishikesh in northern India and is now charting itineraries for the next year or so.

TO LIVE AND DIAL IN BOMBAY

WORRIED ABOUT your job fleeing to India? One strategy is to chase it—an option a growing number of twentysomething Westerners are choosing. Sure, the trend will never make up for the thousands of positions lost back home, but for adventurous young people, a spell in a call center in Bangalore or Bombay can help defray the costs of a grand tour of the subcontinent and beyond.

Of course, *firangis*—or foreigners—have always been part of the Indian outsourcing scene. But until recently, they were mostly highly paid experts from companies that were sending their work abroad, helping the new Indian team learn the processes.

Those folks are still coming to India, but they're being joined by less-experienced people who make little more than the rock-bottom wages paid to locals that are a key draw for multinationals. They typically earn about \$350 a month and work the phones for six months to a year before chilling on the beaches of Goa, trekking in the Himalayas,



WHERE THE JOBS ARE

SUBCONTINENTAL DRIFT

More Westerners are beefing up the résumés with a stint in India

or visiting the palaces of Rajasthan. They often get their airfare to India paid by their new employer, live for free in a company flat with other foreigners, and receive free transportation to the office. "It's a win-win situation," says Sreeram Iyer, chief executive of Scope International, the Chennai-based human resources and software development outsourcing operation of Standard Chartered Bank. "We're not looking for tenure at all," he says.

Despite India's seemingly limitless pool of workers, these foreigners make up a small but growing part of the outsourcing industry. Even as call centers are the job choice for millions of young Indians, employers are getting choosier about people they hire, and it's tough to train foreigners to speak the kind of colloquial English, French, Spanish, German, or Dutch that customers want. Although no one knows for sure how many young foreigners are answering phones in India, some 30,000 expats today work for Indian tech outsourcing companies, about triple the number two years ago, says the International Association of Software & Services Companies, the industry trade association.

And that's just the start. The country's outsourcing industry will need some 160,000 workers with top-notch foreign-language skills by 2010, estimates EY.



FAR FROM FINLAND
Koivukangas is now a supervisor

Foreign workers typically earn \$350 a month



re, a Delhi-based company that pro-
s research services to corporate clients
ldwide. But in the next five years, Indi-
schools will only produce 40,000 or so
ds with the proficiency needed for those
. Evalueserve expects foreigners to
ce up the difference.
evalueserve is helping to kick-start the
d. It employs 40 foreigners on a staff
OO serving clients in 65 countries, and
is to add another 150 *firangis* this year.
is important to have cultural contact
language skills to enhance our offer-
s," says CEO Ashish Gupta. As an af-
te of eBookers—which serves clients
n across Europe—Tecnovate is also
ling the way. More than half its work-
40 out of 70, are Europeans. Next
the company wants to add another
en or so. And Pune-based outsourcer
Ltd. hired a London employment
ncy to recruit 11 young people when it
a contract to provide customer serv-
for a British company. "It helped us to
chmark our people doing the same
" says GTL's human resources chief,
and Desai.

The trend is also being fueled by the
changing customer base of India's out-
sourcing shops. Traditionally, they fo-
cused on serving companies with cus-
tomers in the U.S. and Britain. But now
they're looking to boost their business
from Europe. In 2004, 64% of all out-
sourcing contracts came from the U.S.
and Britain. Just 29% came from the rest
of Europe, but that number could jump to
40% within five years, Nasscom says.

Some companies are getting creative to

THE STAT

30,000

Foreigners working at Indian
info tech and outsourcing
companies—triple the
number two years ago

Data: National Association of Software & Service Companies

EXOTIC LIFESTYLE

Vock earns
enough to "live
well and travel"

keep the pipeline
filled with new re-
cruits. Obtaining
work visas for for-
eigners in India re-

quires hours of standing in line for per-
mits. And visas are only given for a year, so
anyone wanting to stay longer has to re-
peat the process. To get around those has-
sles, eBookers hires recruits in Europe and
then transfers them to India. While it takes
a week or two in Europe to process a visa,
getting a work permit on the ground in In-
dia takes three or four months.

"REVERSE BRAIN DRAIN"

THERE'S EVEN A NEW group of service
providers to help supply India's out-
sourcers with hires from overseas. In Oc-
tober, 2004, Tim Bond—a 32-year-old
consultant to offshoring companies in
Britain—set up Launch Offshore, a Lon-
don recruitment firm that caters to Indian
call centers. He has found jobs for 100
workers, and this year expects to place
200 more. Headhunters India, a leading
tech staffing company, says it gets about
300 unsolicited foreign résumés every
month, and has found jobs for about 100
expats in the past two years. "Call it re-
verse brain drain," says Managing Direc-
tor Kris Lakshmikanth. At Team Lease
Ltd., India's largest temp agency, résumés
pour in from Africa, Japan, Poland, and
Latin America. Although many are from
travelers looking for quick cash while vis-
iting India, Team Lease has placed some
recruits with the likes of IBM and Dell.

The workers don't come only for ad-
venture. Many have had trouble getting
jobs in their native land. Nine months
ago, Kenny Rooney, a 28-year-old Scots-
man, moved to India to answer phones
for GTL in Pune, and quickly advanced to
become a trainer and team leader. "India
provided me a growth opportunity that
wasn't there back home," he says.

More important, time spent answering
phones in India can also work wonders on
résumés. Kati Koivukangas, for instance,
was working at a travel agency in her na-
tive Finland when she heard that an out-
sourcing company in New Delhi was hir-
ing. Koivukangas, a 28-year-old graduate
in tourism and hotel management from
University of Helsinki, jumped at the
chance and has been in India for more
than two years. She has worked her way
up the ladder, now overseeing a dozen
other Finns who answer calls. "I'll hang
on for another six months and then make
a call on what to do," she says. "Not only
do I get to see the country, but the Indian
experience looks good on my CV." ■



CHINA

VENTURE CAPITAL'S NEW PROMISED LAND

China is hot—but the best plays may lie outside of technology

BY FREDERIK BALFOUR

TWO YEARS AGO, THOMAS Tsao had a difficult time raising money for his China venture-capital fund, Gobi Partners. Silicon Valley investors were still smarting from the tech meltdown, the mainland was dealing with the SARS outbreak, and getting cash out of China was proving difficult. "It was like pulling teeth," recalls Tsao. "Nobody was interested."

These days venture capitalists from Silicon Valley to Sydney are trolling for deals in China. "Now everybody wants to come in," says Tsao, who had to turn investors away from a \$50 million China fund that closed in October. Among the fund's investors: IBM, NTT DoCoMo, and The McGraw-Hill Companies, the parent of *BusinessWeek*.

For China funds, the money keeps pouring in. In 2005, they raised some \$1.17 billion, up from just \$325 million in 2002, according to Hong Kong-based *Asian Venture Capital Journal*. IDG-Accel China Growth Fund's new China fund raised

\$150 million, Sequoia Capital China attracted \$300 million, and JPMorgan Chase recently launched funds to invest in China. Carlyle Group paid \$375 million for an 85% stake in state-owned Xugong Group Construction Machinery, and Warburg Pincus ponied up \$115 million for a 22.5% stake in Harbin Pharmaceutical Group. In December, SVB Financial Group, a Santa Clara (Calif.) institution specializing in VC financing for technology, opened a Shanghai office. Says Daniel Quon, SVB senior vice-president: "We will try to be the gateway to connect entrepreneurs with the [VC] ecosystem."

Behind the changed mood have been such private equity success stories as Focus Media Ltd., an operator of elevator and supermarket flat-screen TV advertising signs whose NASDAQ-listed shares are up 112%

IN SHANGHAI
SVB Financial's Quon (right) at the new outpost

since the company's July initial public offering. Similar Baidu.com Inc.,

Chinese-language

search engine, is up 145% since its August IPO. And Yahoo! Inc.'s \$1 billion purchase of a 40% stake in Alibaba.com Corp., the operator of online marketplaces, has further focused interest on Chinese tech companies. What's more, China's fast-growing private sector is now nimble and more innovative.

The money is everywhere. Just ask Gao Wang. In April the 32-year-old Fujian native, who earned his undergraduate and masters degrees in engineering in the U.S. before receiving an MBA from INSEAD France, launched Toodou.com, a video podcasting site that serves up amateur films. Although Wang's Shanghai company doesn't yet have any revenues, he spoke to nearly 30 different VC firms. Wang finally agreed to an investment from IDG of several hundred thousand dollars for a minority stake.

TOO EXUBERANT?

BUT WATCH OUT. With so much money sloshing around, there's bound to be trouble. Deals that were passed over by seasoned investors a year ago are now getting resurrected, a sign that the market is overheating. "There's a lot of exuberance in the market," says Wayne Tsou, managing director of the Carlyle Group in Hong Kong, which has been investing in China since the late 1990s. "In our view, in hot sectors like mobile-phone services and Internet gaming there are hyped expectations."

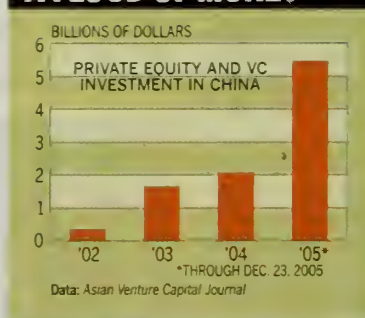
One way to avoid those sky-high prices is to move out of the tech sector, where companies are often run by repatriated

mainlanders known as sea turtles, who have applied Western business models to Chinese Internet and mobile telephony markets. Outside tech, it's another world. Venture capitalists find themselves dealing with folks who have never left home, speak no English, have never even heard of venture capital.

who have survived the rough-and-tumble of the local marketplace.

But this group has made big money for the VCs who backed them—and they are expected to prove to be the China play of 2006 if the market gets too hot to touch. ■

A FLOOD OF MONEY



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The Strip's Spellbinder

In Las Vegas, impresario Franco Dragone is finding it harder to top himself

BY CHRISTOPHER PALMERI

DURING TWO SHOWS A night of the \$110 million production *Le Rêve* in Las Vegas, director Franco Dragone oversees a cast whose stunts seem to defy nature. On stage at the opulent new Wynn Las Vegas Resort, a dozen women in ruby-red slippers swim upside down underwater in a million-gallon pool, their synchronized legs dancing above the surface. A man in a coat prances around a streetlight that floats in the air. Rain pours, doves fly, and snow falls. And that's just what the audience sees. It takes 11 technicians to light the show, 16 divers to assist underwater, 10

dressers, 14 riggers, even a full-time elevator operator. More than 800 towels are used per day—95 loads of laundry in all.

Le Rêve is the kind of production that only Las Vegas, with its billion-dollar casino backers, could possibly afford. And it's a form of spectacle that Dragone largely invented. The 53-year-old director was an early contributor to Canada's Cirque du Soleil troupe before forming his own production outfit in 2000. And he directed singer Céline Dion's show at Caesars Palace, which has been seen by nearly 2 million people since it opened in 2003.

Next to Cirque co-founder Guy Laliberté and casino mogul Steve Wynn, Dragone is probably the man most responsible for helping Las Vegas become the world's capital of live entertainment. Today, 86%



BIO

Franco Dragone

He is credited with inventing the kind of extravaganzas now popular in Vegas:

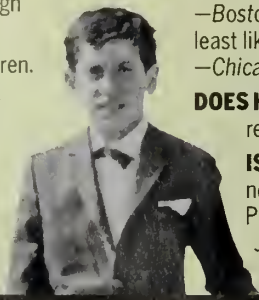
BORN Dec. 12, 1952, in Cairano, Italy.

POSITION Founder and artistic director of Dragone Group.

EDUCATION Studied at Belgium's Royal Conservatory at Mons, a high school for the arts.

FAMILY Married, two children.

CLAIM TO FAME Dragone directed 10 of Cirque du Soleil's most famous productions, including *Mystère* and *O* in Las Vegas and *La Nouba* at Disney World in Orlando.



HIS OWN PRODUCTIONS: A *New Day...*, singer Céline Dion's show at Caesars Palace and *Le Rêve*, the new extravaganza at the new Wynn Las Vegas. Initial reviews of *Le Rêve*: "A giant belly flop." —*Boston Globe*. "The Vegas extravaganza least likely to succeed long-term." —*Chicago Tribune*

DOES HE READ CRITICS' REVIEWS? "I read them. I try to resist."

IS CELINE ON HIS IPOD? "I was never a big fan until I met her. I like Prince, Madonna, Sting, and John Coltrane."



of Vegas visitors see a live show, need double the percentage of a decade ago. "He has added a lot more class to the gas scene," says Jerry Fink, the theater viewer for the *Las Vegas Sun*.

BOX OFFICE BLUES

PACKING A FULL HOUSE in Vegas is longer a sure thing, even for a pro Dragone. For one thing, the competition is fierce. New York transplants *Mam Mia!* and *Blue Man Group*, not to mention original productions like Cirque's \$10 million *Kà* at MGM Grand, are all drawing on the same audiences. It was telling that in late November, *We Will Rock You* stage show based on the popular music of the rock-group Queen, quietly shut down at the Paris Las Vegas casino. Ticket sales for both *Le Rêve* and *Avenue Q*, the Tony Award-winning musical that recently opened at the Wynn resort, have been running well below capacity, too. "Something has changed in Vegas," Dragone says. "Before, you could just open a door and people would come. Now you need to sell."

Suddenly, Dragone finds himself working feverishly to tweak *Le Rêve* to maximum crowd appeal at the same time he is preparing for a major

DREAMER Dragone and the cast of *Le Rêve*, which has seen disappointing ticket sales

step in his career—staging an entirely new version of *Carmen* on Broadway in 2007. But first he has to make sure to save *Le Rêve*. Last year, audience objections forced him to take out one of its most visually arresting scenes, pregnant women in white gowns falling from the sky. Although *Le Rêve* has no real storyline, Dragone added scenes to emphasize that it represents one man's chaotic dream. "I don't like it when people grab me by the nose and say: 'See this,'" he says with a sigh. "I want to be teased."

If there is one common thread in Dragone's work, it is that he is loath to condescend to his audience—an ap-

proach he says comes from his working-class roots. Born in Italy, Dragone and his parents moved to the small Belgian industrial town of La Louvière when he was 6. (Dragone still operates most of the year from Belgium and employs 70 people there to work on the costumes and casting.) His father worked in a steel plant; his mother in a factory that made lamps. Franco developed a love for the theater while attending a high school for the arts. He says his parents never believed that anyone would be able to make a living putting on shows. It wasn't until 1995 that he felt comfortable taking them to one of his productions, Cirque's *Aleka*. "My father said: 'I'll never tell you what to do again,'" he recalls.

Dragone's backer, Steve Wynn, isn't making the same promises. He insists *Rêve* is profitable but is still recommending that Dragone add more "sensuality" to the production. "Franco and I have the same attitudes toward work," says the mogul. "We're never finished." That's for sure. As Dragone works with Wynn to tweak *Le Rêve*, he is already lining up financial backers for his *Carmen* production in New York. In Vegas, they all that doubling-down. ■

Aetna: Succession At Full Speed

Can incoming CEO Ron Williams keep the health insurer on its hot streak?

BY JESSI HEMPEL

AETNA PRESIDENT Ronald A. Williams and Chief Executive John W. "Jack" Rowe have accomplished two feats surprisingly unusual in the corporate world these days: Over the past five years they have revived a troubled company in an intensely competitive industry, and now they are pulling off a carefully planned succession.

One of the reasons for their success is how well they complement each other. Rowe is a renowned 61-year-old geriatrician and former head of Mount Sinai NYU Health, one of the country's largest private hospital systems. Williams, 56, is

a lifelong insurance executive who built his reputation at troubled companies. Rowe is an outspoken and charismatic leader who told an investor at the onset of his tenure, when Aetna Inc. still symbolized all that was wrong with managed health care, to think of the corporate turnaround as a trip to the airport: He couldn't predict which red lights they'd hit on the way, but he promised they'd eventually get there. Williams, by contrast, is so soft-spoken that he brings down the volume in an entire room. While Rowe is the visionary who has been responsible for reshaping how Aetna runs, Williams is the operations czar

ROWE AND WILLIAMS The innovator and the operations czar



who has put those ideas into practice.

Together, Rowe and Williams turned Aetna into an industry leader. The company has introduced innovative products, influenced health-care policy, and beat its rivals in profit growth for the past two years. Its stock is up some 700% since May, 2001, when business was so bad Rowe gave up predicting earnings for the year. Aetna's market valuation is \$27 billion, up from \$3.3 billion in 2001, and net earnings in 2006 are expected to be about \$1.3 billion, vs. a net loss of \$279.6 million in 2001.

But come Feb. 14, the partnership will end, leaving Williams with some serious challenges. He will assume the role of CEO while holding on to his job as president of the company. That puts him in the difficult position of having to keep Aetna growing at a time when consolidations have narrowed the industry to just three significant competitors—and Aetna has roughly half the membership of the other two, UnitedHealth Group Inc. and WellPoint Inc.

Williams will be alone at the top, responsible for the company's strategy. His plan is to provide more of what has made Aetna so successful. But many of those big ideas came from the man who is retiring. "I really need to see that he defines himself, whether it's through a certain type of product development offering, whether it is in going into a certain region," says Ken H. Tsuboi of RCM Global Investors, which holds 3.3 million Aetna shares.

QUALITY, NOT QUANTITY

WILLIAMS' FOCUS has always been internal. He specialized in operations in his previous positions at WellPoint and its subsidiary, Blue Cross of California. At Aetna, his office was on the first floor of the Hartford headquarters, while other executives sat on the eighth. Williams holds quarterly meetings with approximately 5,000 managers and supervisors, or nearly 20% of Aetna's 27,000 employees. He regularly updates a column called "Ask

BIO

Ron Williams

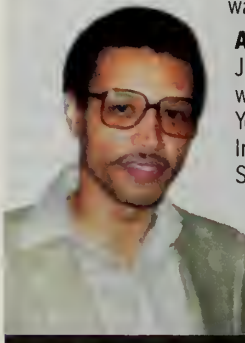
The insurance veteran loves jazz and Bogart

BORN Nov. 11, 1949, in Chicago

EDUCATION BA in psychology, Roosevelt University in Chicago, 1970 (he was an administrative assistant by day, student by night); MS in Management, Sloan School of Management at Massachusetts Institute of Technology, 1984

FAMILY Married to Cynthia; one son, 19

FIRST JOB Detailing cars at a local car wash, age 14.



AFTER HOURS

Jazz enthusiast who frequents New York's Blue Note, Iridium, and Jazz Standard; film buff who favors *Casablanca* and *Treasure of the Sierra Madre*

Ron" on the company intranet, where employees from all over the company pose questions and offer suggestions.

When it comes to company strategy, Williams, like Rowe, believes that better profitability will come from improving the quality of Aetna's products rather than increasing the number of subscribers. When Rowe became CEO in September, 2000, he moved quickly to settle outstanding lawsuits with doctors and dentists, laid off 15,000 employees, and slashed the customer base to a low of 13 million, from 21 million members. Rowe did that in part by jettisoning almost half the counties in which Aetna offered Medicare. Today membership stands at 14.65 million and is expected to grow by

at least a million over the next year.

It was Rowe, with his years of clinic experience, who established Aetna as an innovator. He led the charge to create health savings accounts, employer-sponsored funds that give people a set amount of money to spend on medical care. He created the industry's first guidelines for genetic testing. And he found a way to save money and improve care by ranking doctors and then rewarding members who choose physicians in the top tiers.

Williams' idea is to get employers involved, too: Companies could encourage employees to select recommended physicians by adding funds into their health savings accounts. "We all believe that quality costs less," said Williams in an exclusive interview before the Jan. 4 succession announcement. "Getting members see physicians who seem to have better outcomes will result in better quality for the member." He expects this program to be in place by early 2007.

The company has also taken a lead in the controversial practice of collecting racial and ethnic data about its subscribers. It does so, Williams says, as a way to address the now widely accepted problem of disparities in health care based on racial, ethnic, and even genetic differences. "Many of us initially believed those differences are based on economic status or the presence of insurance," says Williams, who says he has seen these gaps in the African-American community. But, he explains, those disparities are also a result of a medical establishment that doesn't always appreciate "cultural differences" in eating habits, exercise habits, for example.

That's all well and good, but analysts believe Aetna must also cut costs—a suggestion Williams agrees with—and consider big acquisitions, maybe even a merger. Williams is interested in buying other companies he says. When it comes to talk of a merger, though, he says any incoming CEO would: nothing.

—With Diane Brady in New York

Maintaining Aetna's Momentum

Here's what incoming CEO Ron Williams could do to keep up in an industry with little organic growth:

CUT OPERATING COSTS

» Despite recent dollar-saving measures, the company still has some of the highest operating costs in the industry.

INCREASE OFFERINGS

» Its Aexcel network, which allows employees

to search a database for doctors with the best track record, is drawing new customers.

TARGET BOOMERS

» Aetna could find new subscribers by developing products and innovations for baby boomers and their parents.

BUILD UP M&A

» Smaller acquisitions like the purchase of medical-records company ActiveHealth Management last May provide Aetna new product lines, while a larger acquisition or entry into a new region could provide a substantial spike in subscribers.

What would you do without the internet,
video games and text messaging?



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Vehicle shown with available equipment. ©2005 Toyota Motor Sales, U.S.A., Inc.

LoJack's Stronger Signal

How the maker of theft-recovery systems for autos is jump-starting its sales

BY BRIAN HINDO

WILLIAM R. REAGAN was never a cop, but as town selectman in Medfield, Mass., in the late 1970s, he carried a badge and held the title of police commissioner. One night in 1977 he pulled someone over who turned out to be a paroled convict. A thought nagged at Reagan: "He could have had a pistol on his lap and blown me away." That episode, Reagan says, spurred him to develop a radio tracking device designed to help police recover stolen cars and reduce the number of dangerous stops. He called his invention LoJack—"it's the antithesis of 'hijack.'"

Almost 30 years later, LoJack Corp. has become an unlikely growth story. Under new management (Reagan cashed out by the late 1980s), the Westwood (Mass.) company has spent the past three years fine-tuning its sales approach. Over that period, LoJack's profits have soared an average 68% a year on sales that have grown 19% annually—good enough to be No. 42 on *BusinessWeek's* Hot Growth

**HOT
GROWTH
COMPANIES**

Companies ranking of small companies. Reagan and a handful of investors took LoJack public two decades ago, but lately investors have taken notice: Its share price has risen from \$4 in 2002 to around \$23 in 2005.

A 2001 strategy makeover jump-start-

ed sales and profit growth. Until then, LoJack mostly sent its own folks out to install its tracking devices, which are about the size of a deck of cards and are hidden in various spots in the car. Former Chief Executive Ronald J. Rossi, an ex-Gillette executive, shifted much of the installation work to auto dealers, who have long sold the lion's share of LoJack systems. "They like the profit opportunity on installations," says current CEO Joseph F. Abely.



He figures that dealers, who buy the units wholesale from LoJack, can clear up to \$400 per unit sold. That incentive has driven LoJack's market penetration from 4% of all cars sold in the U.S. in 2001 to more than 6% in 2005, according to David Gold, an analyst for New York investment firm Sidoti & Co.

With dealerships taking on more of the installation burden, LoJack's expenses have grown more slowly than sales, benefitting the bottom line. Andrew Spinola, an analyst at investment bank Needham & Co., expects the company's operating

margin to hit 16.2% in 2006, up from 9.8% in 2003. Sales are growing at a healthy clip, and an expansion into Europe this year should help. Spinola projects sales of \$209 million in 2006, up 11% and net income of \$21.8 million, up 26%.

GPS COMPETITION?

RIVALS ARE RACING to catch LoJack's lead. Ituran Location & Control Ltd., an Israeli company with a similar tracking technology, made its debut on the New York Stock Exchange this fall. For now, it doesn't plan a big presence in the U.S. market, but it's a player in South Korea and China—important potential markets for LoJack. And auto companies continue to offer enhanced global positioning systems (GPS), such as General Motors Corp.'s Onstar. Analysts say it would be easy for a carmaker to tack a theft-recovery system right onto a GPS tracker, effectively beating LoJack to the punch. Abely says that GPS trackers are presently displayed on the car's console to use antennas. That makes GPS easy for a thief to defeat.

To stay ahead of the pack, LoJack started to deploy some of its \$16 million in cash. In late 2004 it acquired Canadian company Boomerang Tracking Inc., which offers LoJack-type service in Quebec. That gets LoJack into a new market and also brings in a second key technology. Boomerang works off cellular signals, which are much more prevalent than the radio waves LoJack uses to track stolen vehicles. Pending Federal Communications Commission approval, LoJack could develop products with a cellular backbone, which would allow it to target the cars and hazardous materials tracking business.

That would mark quite a jump for LoJack, which has bubbled into the American consciousness with a 1990s campaign featuring stolen car stories. "You bought a minivan [on Howard Stern], but he'd give you three, or four," says Abely. As for investors, Reagan, now 70, he has no financial stake in LoJack's future, but he's still tinkering with tracking devices. His new project is a gadget for backpacks to help locate kidnapped children. Says Reagan of the technology he dreamt up long ago: "It's technically limitless." ■

CEO ABELY LoJack is diversifying from radio to cellular technology



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MACHINES

Sales-hungry auto makers are innovating at full speed—
and giving buyers the power to shape their vehicles

BY LEE WALCZAK AND DAVID WELCH



TAKING CONTROL

The Pre-Safe system on Mercedes' S-Class will hit the brakes if it senses a crash ahead

THE NEWS OUT OF DETROIT HAS BEEN dismal—a steady drumbeat of job cuts, shuttered factories, and dwindling market share. But lost amid the bad news is another phenomenon, one that's visible at any showroom in the land: There's a new golden age of automotive design and technology dawning.

As fierce global competition drives manufacturers to load up vehicles with once-exotic technologies and to offer more sophisticated styling for the masses, consumers are seeing an explosion of car choices. Aided by advances in manufacturing and spurred by the recognition that standout design is a competitive necessity, the number of car models, niche vehicles, and options is multiplying at a dizzying rate. Even proletarian brands like Saturn are trying to make a fashion statement with cars like the new Sky roadster (on the cover), a budget-priced stunner for which General Mo-



SCION tC Drivers can run their MP3 players through the car's stereo system

tors Corp. developed a special low-cost frame that allows maximum style at a minimum cost. As auto makers embrace the push toward personalization, consumers are gaining the ability to tailor a car purchase to suit their individual lifestyle—and getting a lot more automotive bang for the buck.

The all-out effort to meet demands for cars that reflect consumers' personalities represents nothing less than a reshaping of the automotive industry's future. "The all-purpose family car is a dying breed," says Art Spinella, president of CNW Marketing Research in Bandon, Ore. Technology affords a previously unknown level of variety: Japanese-style flexible assembly lines employ smart robots that can weld lots of different body parts onto modular platforms, thus permitting many variations on the same chassis. Advances in computer design and materials science mean a car can go from clay model to dealer floor in less than two years. It adds up to a marketplace where customers' dreams of personalization reign supreme, and where auto engineers and designers can create affordable cars that look like they ought to be on the auto show circuit.

The latest cars are also more of an electronic extension of their wired drivers. Many new models can integrate an iPod, wireless phone, and laptop into a slick communications module. Auto makers are adding sensors to control car stability, and are splurging on collision warnings, in-dash communication centers, and "smart engines" that squeeze out more power and economy. The automobile is "going through a technological revolution that is the most profound in the last 100 years," says James E. Press,

president of Toyota Motor Corp.'s North American operation.

BusinessWeek's first annual car guide sorts through the creative chaos to zero in on the most important advances awaiting consumers. Partnering with J.D. Power & Associates Inc. (lil *BusinessWeek*, a unit of The McGraw-Hill Companies) allows us to tap its extensive database and match demographic profile of car buyers with cars best suited to their wants and needs. (For the ultimate in customization, check out the corner office on wheels on page 62.) Power also helped uncover hidden bargains on the market. And our Frankfurt bureau explored the hot market in Europe for stylish, and increasingly performance-driven, compact cars. One of these pocket rockets is available in the U.S., and more may follow. But their real impact may be to inspire U.S. auto makers to design compacts with enough head-turning appeal and upscale features to convince Americans suffering from high gas prices that bigger isn't necessarily better.

The wealth of choices for car buyers is just going to grow. In 1999, U.S. consumers had 250 models to pick from. By 2008, the number will rise to 330, according to Global Insight Inc., a Waltham, Mass., researcher. That accounts for new car-line SUV crossovers such as the Mercedes R-Class, niche models

like Pontiac's Solstice roadster, inspired muscle cars like Chrysler's forthcoming Dodge Challenge, and juiced-up compacts for young hot-rodde-

The battle for market share is sure to spark more innovation: "Competitive pressure means carmakers are compelled to add features, lower prices, and push technology," says Jeff Scher, chief forecaster for Power. "Consumers will benefit."

To show what all the competition has yielded thus far, this guide focuses on four key fronts: safety, electronic performance, and fuel economy. And with consumers increasingly able to customize vehicles with just a few clicks of a mouse, it also examines the rapidly changing car-buying experience.

SOPHISTICATED SAFETY

ADVANCED NEW SAFETY SYSTEMS don't just help drivers act to trouble, they help them avoid it. Most cars come with a lock braking systems (ABS), and more of today's cars feature side-impact air bags. But consumers can find autos with even better-performing electronic stability controls. ESC systems cars do things like automatically modulate the brakes and ease off the throttle when the car's tires start to lose grip. Phil Headley, head technology engineer for Continental Teves, maker of auto safety gear, says these "active safety systems" can avoid accidents are the next revolution.

The "active" part comes down to computers that can make their own decisions. Take "intelligent cruise control," now a few premium cars. It shoots out scanning beams to detect when a driver is closing in too fast on the vehicle ahead. Some systems warn a driver, but others actually engage the brakes. BMW is working on a more intelligent four-wheel-drive system, which tells a car that is veering out of control to redistribute torque and power between the front and back wheels to help gain control. Crash avoidance systems can react faster than

» In 1999 consumers had 250 models to pick from. By 2008 that number will accelerate to 330

THE 21st CENTURY AUTOMOBILE

Want state-of-the-art safety gear? Top-notch performance? The latest electronic gizmos? Here's what auto makers are offering up

SENSORS

Sensors will light up an icon on the instrument panel or sound a warning drone when drivers are veering out of their lane or are heading toward a possible accident.

HORSEPOWER

Even though fuel economy is hot, the horsepower war rages on. Americans still love to punch the gas pedal, and many newer cars are both responsive and efficient.

AIR QUALITY

Germophobes will love new plasma-based technologies that release charged ions to filter out mold and bacteria. The result: Cleaner air inside than out.

DIAGNOSTICS

Carmakers like GM and BMW offer systems that can run self-diagnostic tests on cars, telling owners when the brakes, engine, or air bags need to be fixed.



SOUND SYSTEM

Soon you'll be able to plug in your iPod or a memory card loaded with your favorite tunes and toggle from track to track using controls located right on the steering wheel.

FUEL ECONOMY

Hybrid-electric vehicles, transmissions with up to eight gears, and high-tech gasoline engines are slowly but surely delivering the fuel economy gains that were promised back in the '70s.

NAVIGATION SYSTEMS

Navigation systems will tell you more than how to get there—soon they'll tell you how not to get there. They will know where the traffic jams and accidents are, and they'll eventually be able to tell you to slow down when coming up on a hairpin turn.

» Electronic stability control is suddenly an affordable option on the Buick LaCrosse and Toyota Camry

mans can, stopping a car about 20 feet sooner, says Priya Prasad, Ford's technology fellow for safety research.

Drivers like Nicole Montague of Menlo Park, Calif. appreciate the technology. Montague got intelligent cruise control as part of the navigation package for the 2005 Infiniti FX 35 all-wheel-drive SUV that she and her husband Brian Ruder, a venture capitalist, leased in October. "Instead of having to concentrate on not getting into an accident while disabling cruise control and keeping an eye on my son, the car does it automatically," says the 34-year-old yoga instructor.

The 2006 Acura RL sedan and several Lexus, Mercedes, and Cadillac models have crash avoidance systems tied in with adaptive cruise control. As they get close to another car, an alarm will sound and all but the Lexus models will brake if a collision seems imminent. With the latest technology, "a car is thinking ahead and acting ahead," even if a driver isn't, says Shiro Monzaki, a top Toyota engineer.

Auto makers say they can save lives with other new features like lane departure warnings. Paired with intelligent cruise control, that could take accident avoidance to a new level. Nissan Motor Co.'s Infiniti M45 sedan and FX 45 SUV sound an alert when a vehicle drifts into another lane. Volvo sells cars in Europe that warn drivers when another car moves into their blind spot. Volvos will have the feature in the U.S. in a year or two,



HONDA ELEMENT The first vehicle with a built-in iPod dock

says Prasad. The next generation of lane departure warnings, which Nissan currently sells in Japan, actually nudge the steering wheel gently to keep a car in its lane. Audi's "lane assist" feature, due out in 2007, sends vibrations through the steering wheel and sounds a warning drone. Another Audi system uses radar sensors built into the bumper to warn drivers of fast-approaching cars in the left lane, and triggers a warning alert in the rear view mirror if the driver makes a move to pass.

For a glimpse of the future, there's the new Mercedes S-Class, an \$86,000 showcase of driver aids. Its Pre-Safe system is similar to the intelligent cruise control of the Acura and Lexus but has an extra "uh-oh" feature. If the computer decides the car is headed for a crash, it brakes, rolls up windows, closes the sunroof, tightens seat belts, and moves seats into the safest position. The car also has infrared night vision, which helps a driver better see pedestrians or a deer not yet in the headlights.

Consumers who want the latest features may need to fork out \$500 to \$3,000 for adaptive cruise control or ESC systems, according to consumer-research site Edmunds.com. But the gear

should get less expensive over time. ESC systems are standard in most luxury models, but proletarian rides like the Buick LaCrosse and Toyota Camry offer them as an option for \$500 more. GM offers its StabiliTrak system on 30% of current models and says it will be standard on the entire range by 2010.

ELEGANT ELECTRONICS

AS AUTOS BECOME EVER MORE WIRED, manufacturers are struggling to do a better job of integrating onboard devices. To complicate matters, drivers want music players, PDAs, and other devices synchronized with their auto's entertainment system. Andreas Zielke, a Berlin-based analyst for McKinsey & Co., cites a study by his firm predicting that electronics in cars will jump from 20% of the cost of building a car today to 40% by 2015.

A cautionary tale comes from BMW. When BMW rolled out its iDrive system in 2002, the in-dash command center created a stir. The idea of using a PC-like central menu to control audio, temperature, and navigation functions seemed clever. But drivers were befuddled by the complex interface. BMW has since simplified iDrive in the 5 Series, which debuted last year. Audi's version in the A6 and A8 sedans is pretty easy to use. Toyota's systems are popular in Europe, but companies like Cadillac and Lexus are keeping their distance: "iDrive-type systems are a distraction," maintains Toyota's Press.

The hot new trend is sensible integration of a car's information, audio-video, and communication functions. Honda Motor Co.'s funky Element was the first to have a built-in iPod dock. Toyota's Scion xA, xB, and tC models let drivers manage their portable players via the car stereo, a feature also on some BMWs. Meanwhile, DaimlerChrysler, Honda, and Toyota lead the way in efforts to add Bluetooth connectivity and ports for laptops.

GM is also pushing the envelope with its OnStar service, expanding it from basic roadway assistance to accepting voice-recognition commands. The subscription service already uses voice commands for cell-phone calls or to get stock prices. Lexus' next LS 460 sedan will have voice controls, too. Scott Nelson, an analyst for Honda's planning group in Torrance, Calif., says: "In a few years, voice-recognition will be good enough to let you say, 'Find me a Beatles tune,' and the stereo will search satellite radio or programmed music and find one."

With the price of electronic components falling, it's not surprising that "black box" technology, which records data on a journey, is showing up in cars. GM's a leader here, with 100,000 subscribers signed up for a feature that runs hundreds of vehicle tests to diagnose trouble. If there's a problem, a signal goes to an OnStar center, which sends owners an e-mail. BMW is starting a similar system using satellite feeds from its navigation unit. In the future, carmakers may hawk software updates that let drivers retune cars or optimize performance for long trips.

PERFORMANCE PUSH

SWOOPY DESIGN AND FANCY ELECTRONICS aren't the only way to lure auto shoppers. Manufacturers are also upping cars' performance in a reprise of the horsepower wars of yesteryear. Monsters such as the new Chevrolet Corvette Z06 are wil-

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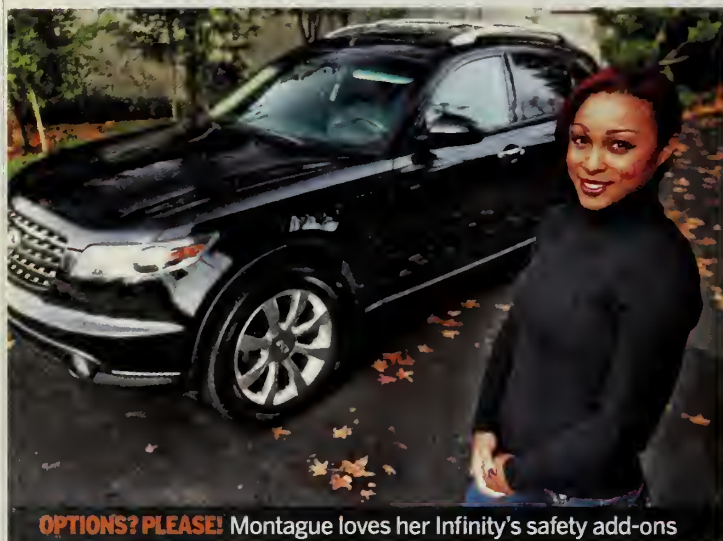
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out of sync with gas prices, but they fetch a premium. The \$65,000 Vette has a 7-liter, aluminum V-8 based on the factory racing motor. Its 505 horses top exotics like the Lamborghini Gallardo, which sells for \$180,000. Chrysler has another hit with the big Hemi engine, which is finding its way into cars like the Dodge Charger and even Jeep SUVs. Power ranges from 330 to 425 hp.

Performance doesn't have to be pricey: Detroit is hawking high-powered bargains for under \$40,000. Last year, Pontiac revived the GTO and gave it 350 hp, but the conservative styling met with yawns. This year the car got another 50 horses (base price is \$33,000), and sales perked up. Across town, Ford Motor Co. has a winner in the new Mustang GT. It offers 305 hp for around \$27,000—and sells loaded for under thirty grand.



OPTIONS? PLEASE! Montague loves her Infiniti's safety add-ons

But it's not all about brawn. Toyota's new Lexus hybrids—which emphasize the high-revving acceleration that electric motors can deliver rather than just horsepower—are getting plenty of interest. Within a couple years, nearly every major carmaker will have a hybrid on the market. Even upstart Hyundai is developing one. "There's a race for horsepower and a race for fuel economy," says GM Vice-Chairman Robert A. Lutz. "It has gone bipolar."

In fact, the next phase of gasoline engine technology is dawning, in the form of direct-injection gas engines. Rather than pump a mix of gas and air into the engine, this technology injects gas in optimum amounts for the kind of power the engine needs. Computer controls decide if the engine needs a lot of the gas for added oomph, or if it should run lean at cruising speeds for better fuel economy. The result: fuel economy rises by as much as 15% and the engine can run faster.

Audi is the clear leader in these engines, which power its A4 and A6 sedans. The \$44,000 A6 gets 255 hp—30 more than the old model—and a 10% rise in fuel economy to 20 mpg. Next year, the Audi Q7 SUV will have a direct-injection V-8 that makes 340 hp while getting 20 mpg on the highway with all-wheel drive. BMW has the new fuel-injection advance in its 438-hp, 19-mpg 760i sedan, and will have it in the 3 Series in 2007. Lexus will also use the technology in its IS 350.

Detroit isn't selling direct-injection gas engines yet. But Chrysler and GM were early to introduce engines that shut down half of a cylinder bank for better economy at highway speeds. Chrysler's Hemi started the cylinder-deactivation kick

and now gets over 300 hp with 27 mpg on the highway, and the new Chevy Impala SS gets 303 hp with 27 mpg. This month, GM's new large SUV will feature the technology to get close to 20 mpg.

FUEL-ECONOMY EDGE

THE BIGGEST ADVANCE on the fuel-miser front is the hybrid electric car. Toyota leads the way, and Press says 25% of sales will come from hybrids in the next decade. This year, it will start selling several new hybrids, including the Toyota Highlander SUV and Camry sedan. Lexus will soon launch the GS 450 h hybrid, pairing its V-6 engine with an electric motor to get 300 hp and the fuel economy of a compact—some 33 mpg.

But despite the \$2,000 to \$8,000 premium buyers pay, many hybrids haven't achieved advertised fuel efficiency in the real world. Still, they'll only improve. A possible breakthrough: switch to lithium-ion batteries, which could cost less and carry more power than nickel-metal hydride batteries. Engineers say car-worthy versions won't be ready for mass sale for five years, but anything that ups battery juice will cut fuel consumption.

Other advances are showing up in the car-buying experience. The interactive build-your-own features on most auto maker Web sites let consumers pick paint, trim, and other options. BMW's site allows buyers to design their dream car and have the dealer zap the order directly to the factory. Many BMW customers do just that, and can flip-flop on wheels, stereo systems, engines, and other options until just six days before the build date. Getting a car can still take months in the U.S., though, if a model's hot.

Mercedes and Lexus also have top-notch sites, but other carmakers are catching up. As computers get more powerful, consumers may be able to do a virtual walk-around of a car they've configured on the Web. It's an alluring vision. But even without such a seamless experience, consumers have never had more power to turn automotive dreams into metal. And auto makers have never had a better chance to prove that smart design and tech savvy can reinvent an industry down on its luck.

—With Ian Rowley in Tokyo, Gail Edmondson in Frankfurt and Ann Therese Palmer in Chicago

Test Drive Autos at BusinessWeek Online

For ongoing coverage of all things auto, visit the new Autos area on our Web site. From hybrids to hot rods, you'll find breaking news, reviews, the latest designs, tips, and more. A sampling:

Build Your Dream Car with our tools provided by J.D. Power & Associates

Auto Reviews for the good, bad, and bottom line on luxury models, economy cars, and everything in between

Auto Design for a look at the trends and strategies shaping cars—and the industry

Classic Cars for what you need to know about buying and owning the vintage vehicle of your dreams

Hybrids for news, tools, and reviews on this fast-growing category

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SEXY Or Sensible?

What you buy to drive may not be what you're driven to buy. **BY DAVID KILEY**

CHOICES, WE HAVE CHOICES. CHOOSING an automobile is complicated. It's partly a rational calculation about transportation needs, partly an impulsive form of self-expression.

Fifties-era tail fins weren't designed because carmakers thought they would appeal to the sensible parts of our psyche. The same goes for rolling bits of automotive whimsy such as today's Hummer H2 and the redesigned Mazda Miata.

So what to buy? *BusinessWeek* set out to find the best cars for a diverse set of U.S. tire kickers. After the magazine outlined the demographic parameters, experts at J.D. Power & Associates (like *BusinessWeek*, a unit of The McGraw-Hill Companies) pored over their data to come up with the top picks in each category. Power bases its research on surveys of owners that measure quality in the first three months of ownership and dependability in the first three years on the road, plus owners' satisfaction with a new car's design, features, and performance overall. While the J.D. Power picks were arrived at analytically, the selections in each group included vehicles that appeal to both the rational side of consumers' brains and to their sheer love of motoring. That's why we're making two recommendations per category: one for the sober left-brain types—you know who you are—and one for their right-brain opposites.

BusinessWeek online Expanded Picks For a slide show featuring more smart car picks from J.D. Power & Associates, go to www.businessweek.com/autos/

BUYERS



TEENAGE TERROR

Every day, a parent somewhere has to make a white-knuckle decision: Selecting that all-important first car for an inexperienced young driver. Obviously, safety, ease of driving, and reliability top the list of desirable attributes.

HONDA CIVIC

(\$14,360-\$23,350) A rock-solid 1.8-liter four-cylinder engine, the Civic is the gold standard for reliability. Power is adequate for a 160-hp. Want to make your teen happy? Opt for the new Civic Si model, which makes you forget the old Civic's standard for dowdy.



RECENT MBA GRAD

Yes, the future's so bright you have to wear shades. But the expenses are piling up, and you're not in the executive suite just yet, so you have to consider your automotive choices carefully.

HONDA ACCORD EX V-6

(\$27,300-\$29,300) Accord has a 3-liter, 160-hp V-6 and comes in sedan and coupe versions. With high dependability, a smooth ride, and excellent crash-test ratings, it's the class president of midsize cars.



SUBURBAN MOM

Talk about multitasking. Suburban women have to juggle the need for massive kid-hauling cargo space, fuel economy, safety, and a desire to blend the utilitarian with the stylish.

TOYOTA SIENNA XLE LIMITED

(\$35,880-\$38,080) A 3.3-liter, 215-hp six-cylinder engine under the hood, the Sienna minivan has a silky smooth ride and a thoughtful interior. The XLE adds all-wheel drive for traction, and a sunroof when chauffeuring those kids in the snuggly.



MID-CAREER EXEC BUSTING LOOSE

With plenty of disposable income and a solid spot on the corporate ladder, many want to make a statement with a new ride. But what should that statement be?

CADILLAC STS

(\$41,020-\$47,520) The STS is back, and this sport sedan says you have arrived. There's a 3.6-liter V-8 engine and a sleek design (for a big car) hand-drawn by a designer, although the drab interior needs updating. The Bose stereo may be a bit out of class.



TITAN OF INDUSTRY

Congratulations, you've made it. But the perks of power include more than stock options and the key to the executive washroom. Your inner mogul wants wheels that are a blend of power, prestige, and speed.

LEXUS LS 430

(\$56,525) This luxury sedan has a smooth 3.0-liter, 278-hp V-8 and the cushiest interior around. It's well-crafted like any Lexus, and the cabin does a terrific job of insulating you from the world. Everything about it whispers perfection.

LEFT BRAIN



RIGHT BRAIN



MAZDA3S

(\$16,880-\$17,615) This hot hatchback has a 2.3-liter, 160-hp, four-cylinder engine. It's quick, with a suspension that's as taut as the Germans make. Young drivers like Mazda's zoomy image and customizing the 3-series. Mom—send money!



BMW 330XI

(\$38,500) The 3-liter, 255-hp BMW has a velvety inline six and superb handling. Opt for the less powerful 325i if you don't want to blow all of the signing bonus. We like the racy transmission that lets you paddle-shift from the steering column.



JEEP LIBERTY CRD

(\$25,125) O.K., forget practicality for a moment. This mini-SUV has a 2.8-liter four-cylinder and makes 148 hp. Its rugged, mountain-goat heritage makes it an alternative to minivans—but only for small families. We chose the diesel version for fun.



BMW Z4

(\$34,300-\$41,300) The Bimmer's 3-liter, 225-hp six loves to spin, and that plus superb suspension tuning make this roadster a joy to drive. The power-operated top has a folding mechanism that allows extra storage space for two golf bags.



PORSCHE 911

(\$71,300-\$87,100) An iconic sports car, the 911 has a 3.6-liter, 340-hp six cylinder that pushes you back in your seat. Road-holding is unworldly. The S model has optional all-wheel drive. Nobody beats Porsche at blending performance and reliability.



"STEALTH LIMO" Mitzi Perdue's JetVan ferries bigwigs

Cruising in the Corner **OFFICE**

Howard Becker's van conversions make one suite ride. **BY LARRY ARMSTRONG**

FROM THE OUTSIDE IT LOOKS like an airport van, the kind that whisks you from baggage claim to a hotel. Inside, though, it's more like a Gulfstream G150 or Dassault Falcon executive jet. There's a curved ceiling with indirect and pinpoint LED lighting, sumptuous leather seats with electrically deployed leg rests, hand-veneered tray tables that stow away in armrests and consoles. A wide-screen TV pops up in the front of the cabin; another drops from the ceiling in the rear.

Welcome aboard the Becker JetVan, a Dodge Sprinter passenger van outfitted with the amenities of a private jet and all the tools of an airborne office, including satellite phones, a docking station for a laptop, and a high-speed Internet connection. It's the brainchild of Howard Becker, a veteran of the custom car business and owner of Becker Automotive Design Inc. in Oxnard, Calif.

"I call it my stealth limo," says Mitzi Perdue, who bought one so her favorite charities could ferry guest speakers and

celebs in style from Philadelphia or Washington airports to fund-raisers in her rural Maryland hometown, a three-hour trip. "If I can provide them with a mobile office, that's not wasted

THE PRICE OF LUXURY

A fully loaded custom job like the one in the Mercedes Sprinter van (right) can cost a small fortune



OPTION	COST
Satellite TV antenna	\$4,500
Satellite telephone system	7,500
PC with high-speed Internet	8,500
Toilet and tanks	12,500
Aviation-style LED lighting	13,500
Independent rear suspension	22,000
Electric window shades	40,000

jet," he says—that he plans to buy a second one to keep in Florida later this year.

The vans are sleek, six-figure propositions by the time Becker is finished with them. He starts with the \$44,000 low-wheelbase, high-roof version (a six-footer can stand up in it) of the Dodge Sprinter passenger van. Built in Düsseldorf, Germany, it's sold as the Mercedes-Benz Sprinter outside North America. Becker restores the Mercedes trim, tunes the turbo diesel engine for more power, and tweaks the suspension for a softer ride.

From there it's whatever the customer wants. Options can drive the price into the \$200,000-to-\$300,000 range. Becker offers a choice of six "standard" floor plans: that seat from four to seven, not counting the driver and one passenger up front. Most buyers opt for a partition between the driver and passenger compartments; when the privacy window is up, it holds a 30-inch flat-screen TV for entertainment and computer displays.

But it's the aircraft-style interior, with extensive use of lightweight, honeycomb-composite materials, that sets the JetVan apart from ordinary van conversions. Becker's newest option takes the private look even further: electric window shades, essentially folding blinds sandwiched between the outside glass and inside plastic. Depending on the number of windows wanted covered, that can cost up to \$40,000 extra.

Becker will also personalize the interior to his customers' tastes. Perdue, daughter of one of



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h a 30 MPG*
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 **TOYOTA** *moving forward* 

founders of Sheraton Hotels & Resorts and widow of Perdue Farms Inc.'s Frank Perdue, wanted hers to reflect the color scheme of a bejeweled Fabergé-like egg she designed. Becker obliged, finding a handmade Pakistani rug with similar colors, refinishing the Rolls-Royce toggle switches for the lighting controls to brushed gold instead of the customary silver, and piping the leather seats in a complementary color. The final touch: He mounted the egg on a Waterford vase that guests pass by when they climb into the van.

MOVING ON UP

BECKER GOT HIS START right out of college working at his father's car stereo store in Los Angeles. In the '70s he moved to a storefront half a block south of Beverly Hills and began pitching upgraded sound systems to Hollywood celebrities and entertainment moguls. As the business grew, he found himself doing complete conversions, revamping big SUVs with posh interiors and lots of electronics. Five years ago he found his customer base changing, too, from the likes of Barbra Streisand and Eddie Murphy to businessmen such as Eric Holm and real estate developer John Scardino, so he decamped Beverly Hills for an industrial park in Oxnard, 50 miles northwest of Los Angeles.

Scardino appreciates the look and feel of the JetVan. He normally travels in Pilatus PC-12 and Falcon 50 jets and often commutes from Los Angeles to California's central coast in his L39 fighter jet. But what he really needed was an office. "My 'offices' are basically the trailers at all our building sites," he says. "There's no phone, no water, no nothing." He prefers to drive himself, so he's having a sliding door put between the driver's compartment and the passenger cabin, and he wants a clothes rack and tiny bathroom in the cargo area behind the rear seats.

Earlier, Scardino tried building an office into a 40-foot mobile home, but it was so difficult to drive and park, that he sold it within six months. When he gets his van in January, it will have a computer, printer, fax, phone, and high-speed Net access. And it will provide a businesslike environment for meetings with his bankers and partners. "If you think about it, it's where I work and where we scout out our properties," he adds. "So now I can have my office in the middle of nowhere, too." ■

Compact, But All **MUSCLE**



Euro carmakers are pouring power into pint-size packages

BY GAIL EDMONDSON

JENNIFER AUBRECHT, A 24-year-old manager at a Frankfurt construction company, likes to push her new BMW 1 Series to the limit. That includes ripping past the occasional snoozing Porsche in a burst of turbocharged acceleration. This smallest BMW, which hit German showrooms a year ago, is no bigger than a Volkswagen Golf. But it blends the performance and styling once reserved for luxury models with the miserly gas mileage of a compact. "It's not only the great design" that appeals to her, Aubrecht says. "It's how fast and how comfortable the car is."

Fast means *Autobahn-schnell*. She has clocked the 600 miles from Frankfurt to Zagreb in nine hours. Her seven-month-old, 163-hp BMW 120 diesel is loaded with extras, including an aerodynamic design, sporty suspension, and a leather interior. "I love everything about it.

Nothing can lure me away from this car," she says.

Europeans have long excelled at making neat small cars, from the cherublike Fiat 500 of the 1950s and '60s to the cuddly Rover Mini. Now the Old World is revolutionizing the boring compact. Forget the utilitarian box. A new generation of Euro compacts boasts racy design, surefooted handling, and engines that are both peppy and economical. BMW's new 1 Series epitomizes the trend, but hardly alone. General Motors' Opel Corsa, France's Renault Clio, and Italy's Fiat Grande Punto are among the new models. More foreign compacts may show up on U.S. roads—Audi's Sportback is already here, and BMW is debating whether to introduce the 1 Series in the U.S. But these models may also serve as an inspiration to reshape America's automotive future.

VW kick-started the trend of juicing the horsepower of a basic Golf in the 1980s with the hot-rod GTI model. The design revolution in Europe's small cars really took off when BMW and Mercedes began their assault on the market with smaller premium cars in the 1990s. Just to compete, every automaker needed a compact with cutting-edge design, one that was nearly as fun to drive as a sports car. Even mass-market French, Italian, and American pro-



BMW 1 SERIES 120D A pacesetter in the turbocharged, sporty field

cylinders. Thanks to 200 hp, it zips from 0 to 60 mph in 6.5 seconds. Next year, Audi will up the ante by launching the all-wheel drive Quattro version, which makes the car even safer.

The Opel Astra may not match the super handling of a BMW or Audi, but it highlights a quantum leap in the design and performance of Europe's mass-market small cars. The Astra had long suffered in the shadow of VW's Golf, the latter remembered mostly for its low price tag, dull silhouette, and puny engines. Suddenly, the fleet Astra, introduced in March, 2005, was blowing its rival Golf off the road. GM Europe President Forster cleverly introduced an optional adaptive suspension system on the Astra called continuous damping control (CDC), which gave computer-controlled shocks and springs at each corner of the car the ability to adapt quickly to road contours and conditions—a first in the compact segment. The shock absorbers react almost instantly to variations in the road surface or driving style and help prevent skids and wheel spin.

There's plenty of power, *natürlich*. The new '06 Astra GTC coupe, with its optional panoramic glass roof and hopped-up OPC performance versions (in Britain, the OPC is called the Vauxhall Astra VXR) comes with a 240-hp turbocharged engine that sets a new benchmark for "hot hatches," topping out at 152 mph. Its cabin resembles a jet-fighter's cockpit. "Design comes first in the eyes of consumers," says Frank Stephenson, an American design ace

who was the artistic force behind BMW's smash hit Mini before moving to Ferrari and then Fiat.

Producing cars with ever-bolder designs is a competitive must for makers of European small cars. Italy's Alfa Romeo has won plaudits for the edgy styling of its new Brera sport coupe, inspired by a 2002 show car from the top Giugiaro design studio. The long hood, low stance, and squinty headlights give the car an aggressive body, while the line above the three round lights was drawn to resemble "an angry, sharply slanting eyebrow," says Wolfgang Egger, Alfa's design chief. The Brera's design is a simple, graphic message, says Christoph Stürmer, senior auto industry researcher at Global Insight Inc. in Frankfurt: "Get out of my way. You know this beast bites."

AMERICA NEXT?

RENAULT'S MÉGANE is another exemplary compact and a design standout. It broke the mold with its avant-garde geometric styling. The bulging tail shape, dubbed the "bustle" by Renault chief designer Patrick Le Quément, makes a statement that no manufacturer has yet to match. Renault's performance sprinter, the Mégane Sport, boasts sportier suspension, great cornering—and does 0 to 60 in six seconds. That's breathtaking performance for a French fashion plate.

Mercedes pioneered the latest innovative step in the compact segment with its B-Class, a luxury "sports activity vehicle" designed to maximize interior space. Aside from the car's luxury trim-

mings and spacious interior, helped in part by the higher roofline, the formula remains the same—power, performance, and design all in a neat, integrated little package. The B200 turbo engine version with 193 hp can top out at 140 mph.

U.S. car buyers may eventually see some of these innovations in their own backyard. After all, with gas prices so high, the American driving public may soon give up on its love affair with imposing bulk and Queen Mary contours. If that day comes, they need only look to the pocket rockets zipping across European highways to see motoring's future. ■

started launching small cars packed with tech-driven innovations such as the road-sensing adaptive suspension systems once reserved for top-of-the-line Fiamers and Benzes. "We wanted to democratize technology and make innovations affordable," says Carl-Peter Forster, president of GM Europe and former CEO of GM unit Adam Opel, describing the philosophy behind the hot-selling Opel Astra.

That meant bringing power to the masses. Small cars were once fitted with unexciting engines. Now, many European makers offer as many as six different engines for a compact, with the most powerful still striving to rank as fuel-efficient. BMW's 1 Series is the pacesetter among compacts, offering precise handling, brisk acceleration, and an outstanding 41.3-mpg fuel rating for combined city and highway driving.

Audi's A3 Sportback, which has just landed on U.S. shores, is hot on BMW's tail. Its turbocharged TFSI engine is one of the few that improve power and economy by directly injecting fuel into the

SMALL, SPEEDY—AND STYLISH

MAKE AND MODEL	ENGINE	HORSEPOWER	MILEAGE (COMBINED)
BMW 1 Series 120D	2.0-liter diesel	163 hp	41.3 mpg
AUDI A3 Sportback	2.0 turbo direct injection	200 hp	30.2 mpg
OPEL Astra OPC	2.0 turbo	240 hp	25.6 mpg
RENAULT Mégane Sport	2.0 turbo 16V	225 hp	26.7 mpg
MERCEDES B Class B200	2.0 turbo gas	193 hp	29.0 mpg
ALFA ROMEO Brera	2.2 gas	185 hp	25.0 mpg

Data: Companies, BusinessWeek



» Chevy SSR

Vehicle specs **6.0 liter, V-8, 395 hp**

J.D. Power category **Midsize pickup**

Average customer rebate **\$3,767**

Average time spent on dealer lot **204 days**

Average price after rebate is applied to sticker price but before negotiating with salesperson **\$39,500**



» Kia Amanti

Vehicle specs **3.5 liter, 6-cylinder, 200 hp**

J.D. Power category **Midsize car**

Average customer rebate **\$2867**

Average time spent on dealer lot **72 days**

Average price after rebate is applied to sticker price but before negotiating with salesperson **\$23,527**

Driving A Hard **BARGAIN**

Finding diamonds in the not-in-demand bin. **BY DAVID KILEY**

SURE, THE TOYOTA PRIUS, MINI COOPER, AND LEXUS

IS 350 are selling at or above their sticker prices because of their newness, novelty, and slick marketing. Dealers are holding all the cards with these hot wheels when it comes to negotiating prices. But there are highly rated, desirable vehicles on dealer lots today that deserve a second and even third look because their manufacturers have flubbed the marketing on either the product or the brand.

J.D. Power & Associates and *BusinessWeek* came up with a list of "fab five" bargains based on how high customers have rated them in Power's Automotive Performance, Execution, and Layout (APEAL) survey, which measures how pleased owners are with the vehicles and the buying process, and how much you can beat down the sticker prices with available rebates and good old-fashioned leverage because of how poorly they're selling. These are "buyer's market" cars.



» Jaguar XJ8

Vehicle specs **4.2 liter, V-8, 300 hp**

J.D. Power category **Premium midsize car**

Average customer rebate **\$1,985**

Average time spent on dealer lot **98 days**

Average price after rebate is applied to sticker price but before negotiating with salesperson **\$66,267**



» Mercury Montego

Vehicle specs **3.0 liter, V-6, 200 hp, AWD**

J.D. Power category **Full-size car**

Average customer rebate **\$1,500**

Average time spent on dealer lot **103 days**

Average price after rebate is applied to sticker price but before negotiating with salesperson **\$24,269**



» Dodge Magnum

Vehicle specs **5.7-liter Hemi, 8-cylinder, 340 hp**

J.D. Power category **Premium midsize car**

Average customer rebate **\$1,550**

Average time spent on dealer lot **154 days**

Average price after rebate is applied to sticker price but before negotiating with salesperson **\$28,361**

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OF NORTH AMERICA,
AND YET SO FAR IN FRONT.**

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Goodrich	08:15
HP	08:45
Placer Dome	09:45
BASF	10:15
Husky Injection Molding Systems	10:50
Boehringer Ingelheim	12:01
Philips Electronics	13:05
Messier-Dowty	13:45
Goldcorp	14:10
ING	14:30
General Mills	15:00
Cognos	15:00
Kuntz Electroplating	15:00
Newmont	15:00
Lucent Technologies	15:00

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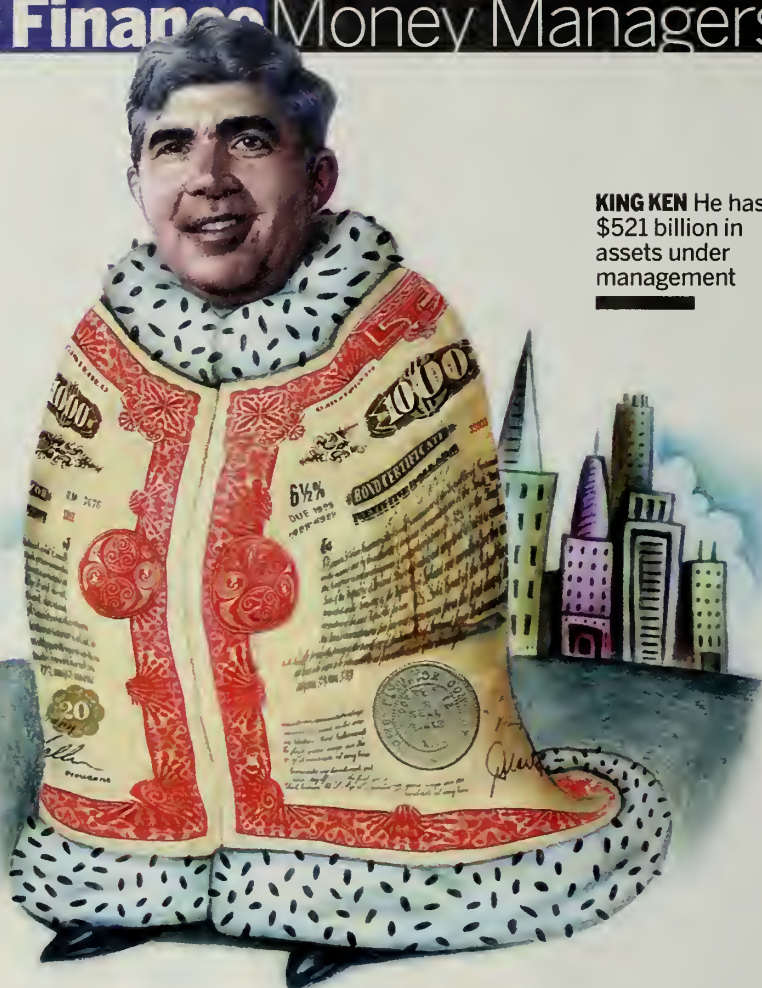
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KING KEN He has \$521 billion in assets under management

Long Live the New King of Bonds

Wamco's Ken Leech avoids flashy moves and keeps an institutional focus

BY CHRISTOPHER PALMERI

AT A RECENT CONFERENCE for investors at the swanky New York Palace Hotel, Bill Miller, the top-performing stock fund manager at Legg Mason Capital Management, bestowed a new honor on his colleague, Ken Leech, chief investment officer of Western Asset Management Co. (Wamco). Miller proclaimed him the "King of Bonds" and joked that "Bill Gross had to step aside," referring to the legendary bond-fund manager at Pa-

cific Investment Management Co. (Pimco). "Ken is now the king, the KOB."

Miller wasn't crowning Leech based on performance, although Morningstar Inc. named Leech its Fixed-Income Manager of the Year in 2004. Rather, Miller was marveling at Wamco's assets under management, which had just surpassed Pimco's. On Dec. 1, Wamco's corporate parent, Legg Mason Inc., acquired Citigroup's money management business and gave a \$280 billion chunk to Wamco. That boosted Wamco's assets to \$521 billion, a shade over Pimco's \$514 billion, according to consulting

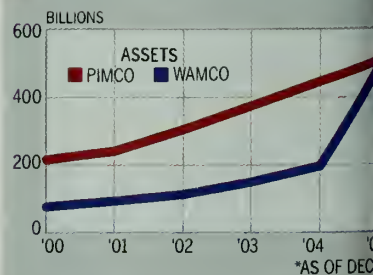
firm Wilshire Associates. New York-based BlackRock Inc. is now third \$428 billion.

Skeptics might say Wamco's ascendancy is merely a result of growth by acquisition. It's a fair point, consider that Wamco's assets effectively doubled after the Citi deal. But Wamco has posted impressive numbers over the years, winning huge money flows into its funds. Since 1999, the firm's assets under management have increased at a 27% annualized rate. Its core funds have beaten benchmark Lehman Brothers Aggregate Bond Index over the past one-, two-, three-year periods, according to data collected by Mercer Investment Consulting. Over the past five years, Wamco has turned 7.7% annually, much better than the index' 6.6% performance. "That's exactly what we're looking for in a fixed-income manager," says William Atwood, executive director of the Illinois State Board of Investment. "They make a little money and don't cause any problems."

Leech, a Wharton MBA who joined Wamco from CS First Boston in 1990, became chief investment officer in 1995. He wears the KOB crown uneasily. Shy and reserved despite his commanding presence, he shuns the limelight and rarely gives interviews. Investors, analysts, and pension-fund consultants say the key to Wamco's success has been its steady focus on large institutional bond clients. Wamco refuses to court individual investors for retail funds, a side of the business that can tempt firms to chase short-term results.

Although Wamco manages about \$5.5 billion in 11 mutual funds that are available to wealthy individual investors, that part of its business pales in comparison with Pimco's, which has \$90 billion in its flagship Total Return fund alone. Wamco's institutional focus isn't likely to change, says Raymond A. "Chip" Leech, son, Legg Mason's chairman and CEO.

BOND AMBITION



Data: Wamco, Pimco, Wilshire Associates

Third Annual, New York City

World Business Forum

Leadership Speaks

Colin Powell

Global Security

Jack Welch

Strategy

Kenichi Ohmae

China, US & the World

Liu Jiren

China, US & the World

Larry Bossidy

Execution

Malcolm Gladwell

Marketing & Innovation

Jim Collins

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Renée Mauborgne

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executive: "When you have somebody who does something well, don't mess with them."

Whereas Pimco is famous for its big-picture views on things like interest rates and economic growth, Wamco is best known for its nuts-and-bolts analysis of individual companies and credits. "It's more of a bottom-up approach," says Bruce Perelman, a member of the investment board of the \$33 billion Los Angeles County Employees Retirement Assn., which has money with both firms.

ENRON EFFECT

LEECH'S BETS haven't always panned out, of course. When corporate bonds began to slide in the wake of the Enron and WorldCom bankruptcies,

Wamco is known for its nuts-and-bolts analysis

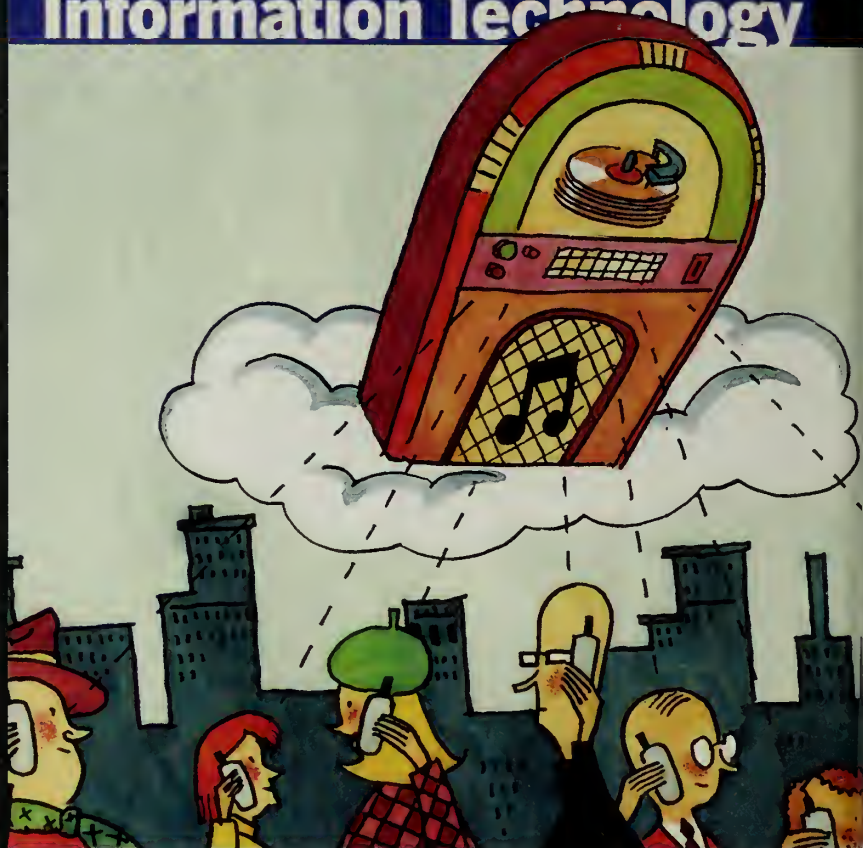
Wamco's results suffered. Leech decided to hold on to his corporate bonds rather than bail out, and finished 2002 below the Lehman index, notes Michael Rosen, a pension consultant at Angeles Investment Advisors in Santa Monica, Calif.

More recently, however, Leech bet that longer-term bond prices wouldn't fall as dramatically as the federal funds rate was rising. Good call: His core funds are up about 3.3% in the past 12 months, vs. 2.8% for the index and similar Pimco funds, according to fund tracker InvestorForce.

Gross declined to comment on Wamco's rapid growth. A spokesman said Pimco would likely regain its top-dog status when \$70 billion in European assets that it manages for its parent company, Allianz Group, are included in its total as part of a long-planned corporate consolidation this month. Still, says Morningstar analyst Paul Herbert, a nagging concern for Pimco investors is that Gross, 60, could retire in the near future.

Pimco lost a likely heir apparent in Mohamed A. El-Erian who has agreed to take over Harvard University's endowment this year. "With Wamco, succession is not an issue," Herbert says, noting that Leech is 10 years younger than Gross. "I think he's got plenty of gas left in the tank." He'll need it to hold on to the King of Bonds title. ■

—With Aaron Pressman in New York



What's that Ringin' In iPod's Ears?

Verizon's V Cast is the phone business' fiercest bid yet to grab away music fans

BY SPENCER E. ANTE

NO, THIS IS NOT STEVE Jobs's worst nightmare. Not yet, anyway. But with the Jan. 5 launch of Verizon Wireless' long-awaited music download service, the mobile-phone service provider is offering American consumers the closest cellular rival yet to Apple Computer Inc.'s celebrated iPod and iTunes combination.

Verizon's new V Cast Music, unveiled at the International Consumer Electronics Show in Las Vegas, will give Verizon's 49 million customers an easy way to buy as many as 1 million songs over the air or on a PC at competitive prices. Sure, the handsets, which start at \$99, don't yet hold a

candle to the elegant iPod. And the new model is still a work in progress with V Cast, the phone giant takes a stride into the music business. "I we'll be a very viable competitor to and other players," says Verizon Wireless CEO Dennis F. Strigl.

Having spent billions over the three years to build a high-speed wireless network, Verizon is keen to tap into growing consumer demand for cell data services, especially music, games and video. Since it launched a primary version of V Cast last February, the carrier has managed to sell a respectable 2 million handsets equipped for music snippets and video.

Now the phone giant is looking for new music service to turbocharge its

ital offerings. Much the way Apple uses the barely profitable iTunes Music Store to help sell iPods, Verizon is brandishing a music service to entice subscribers into signing up for V Cast. Even if the company fails to sell loads of songs, it will be collecting the \$15 a month subscription fee on top of its basic service charges. That's why Verizon projects that data services—driven by music, games, and its already popular ring-tone offerings—will account for 25% of revenues by about 2011, up from 6% today. “Music is the centerpiece for V Cast,” says Verizon Wireless Vice-President and Chief Marketing Officer John Stratton. “I’m a pretty serious iPod fan, but I don’t bring it with me everywhere I go.”

COUNTING ON AIR

VERIZON'S MOVE also provides a boost for the rest of the phone industry. “There is finally start-

to be a choice of services for consumers,” says Jonas Geust, vice-president for music at handset maker Nokia Corp., which is not involved with Verizon's V Cast. “It’s good to have some new competition.”

What exactly is V Cast Music? Like Nextel Corp.'s service, which launched in late October, V Cast lets consumers download songs over the air. Both Verizon and Sprint services provide copies of each tune—one for the phone plus a higher-quality file that can be downloaded to a PC. Verizon is undercutting Sprint on price, though: \$1.99 per song for the air download, vs. Sprint's \$2.50. Still, no one is sure whether Americans will be willing to pay twice what it costs to download a song over the air. Yes, such services are thriving in South Korea and Japan. But those nations are more cell-phone-centric than the U.S., which has opted to put the PC at the center of the music experience. This may explain why Verizon has adopted a two-track model for its music service. In a first for a wireless carrier, the company will allow consumers to go online and buy songs for the same as at iTunes. Subscribers will be able to transfer those downloads to songs on CDs from their PCs to their phones through a USB cable.

To further hedge its bets, Verizon is launching a subscription-based music service that could be launched later this year.

Many analysts believe the subscription model fits better with the phone because handsets cannot hold as many songs as a single-use device. Subscriptions also have proven popular with wireless callers in South Korea and elsewhere. “We’re well set up to do that if we choose to do so later in the year,” says Stratton, who notes that Verizon chose Microsoft Corp.'s Windows Media Player as the central technology for its V Cast Music service partly because it supports subscriptions.

A broad selection of music is key to drawing in mobile-phone users, and Verizon is clearly aiming to equal iTunes on that front. When the service goes live on Jan. 16, the Verizon store will offer more than 500,000 songs; by the end of the first quarter it plans to serve up 1 million tunes. Besides cutting deals with all four major record labels, Verizon, unlike Sprint, is also selling music from an indie distributor, in this case Orchard, which has hundreds of artists ranging from Billie Holiday to the punk band Black Flag. While iTunes already has topped 1 million songs, Sprint's service now stands at only 300,000.

Matching Apple's snazzy hardware will be the cell-phone industry's biggest challenge. Verizon has worked with three handset makers—LG Electronics, Samsung, and UTStarcom—to design phones specifically to handle music. All come with stereo speakers, which sound much better than the speakers typical of cell phones. And the V Cast software is fairly intuitive, including a feature that lets users preview songs for 20 seconds. The Verizon-branded phones will also offer more bang for the buck than rival phones. Verizon's cheapest, Samsung's model a950, will cost \$99 and includes

very little memory. For \$99 more, customers get a 1-gigabyte memory card that holds 700 songs. Stratton hopes Verizon music phones will compete at the low end of the market, now dominated by cheaper, lower-capacity iPods, such as the shuffle and the nano.

EARLY SALVO

STILL, IF THE IPOD is the BMW of music players, then Verizon phones are more like the Honda Accord: They work well and look fine, but they don't yet offer the same hip package of design and performance as the iPod. “You need a strong device to compete with the iPod, and at this point no one has come up with such a thing,” says Michael Gartenberg, vice-president of JupiterResearch.

And who knows what Steve Jobs has up his sleeve? He's not talking. But when he presides over the Macworld Conference & Expo in San Francisco from Jan. 9-13, many analysts expect him to announce a new iPod shuffle and a device that lets consumers manage the digital media in their homes. Some analysts think he could throw the industry for a loop by cutting a deal with a cellular carrier to launch an Apple-branded wireless network—that would offer over-the-air content and allow Jobs to retain control.

Then again, V Cast Music is only an early salvo in a war that will play out over the next five years. Verizon already plans two new upgrades for V Cast this year. The company is also busily working on new content deals, new handsets, new applications, and new pricing models with the music labels. Says Stratton: “This is the beginning of a series of evolutions.” ■

Call of the Wireless

Why Verizon's new music service could eventually challenge Apple



DECENT PRICING Over-the-air downloads will sell for \$1.99, 50¢ cheaper than Sprint Nextel's service. Music phones will retail for as little as \$99 after discounts. Add a \$99, 1-gigabyte memory card that can store 700 songs, and the total price is comparable to that of a low-end iPod. Verizon is also mulling a subscription service for later this year.

ONLINE SHOPPING Verizon breaks new ground for a wireless carrier by letting subscribers go online to buy songs for 99¢, much the way you can with iTunes. And, like Sprint, Verizon lets people transfer tunes from their PCs to their phones.

SOLID CONTENT Thanks to deals with all four major music labels, plus one leading indie distributor, V Cast Music will launch with more than 500,000 songs and offer 1 million by spring. iTunes already offers more than a million songs, but Verizon is way ahead of Sprint's 300,000-song catalog.

crossing the **gene** barrier

**by arlene
weintraub**

Goats throughout history have been symbols of vitality and cunning, and treasured for their silky fur and nutrient-rich milk. But Sweetheart, a brown-striped goat with soulful eyes, has a secret that could elevate her far above this illustrious legacy. Named for her laid-back disposition, she has a single human gene in the twined strands of her DNA that enables her to produce a life-saving drug in her



MEADE From 4-H to creating Sweetheart, a transgenic goat

SHAWN C. HENRY

milk. It's a protein that's normally found in human blood.

In ancient times, the Greeks revered the god Pan—part-man, part-goat—who defended Athens against the Persians. Today, the dash of humanity imbedded in Sweetheart and 59 other goats at a central Massachusetts farm could provide a different but equally vital line of defense. Some people don't make enough of the protein in their livers, explains Harry M. Meade, the chief scientist at the company that created her. That raises the risk they'll suffer fatal blood clots during surgery. Others, such as burn victims and heart surgery patients, need a bit more of the protein to speed their recovery. If regulators in Europe approve Sweetheart's elixir in February, as expected, it's likely to be the first drug on the market derived from the milk of a part-human "chimera"—a creature that bears the cells of two or more species.

A Tale of Two Scientists

THREE THOUSAND miles away, scientist Nils Lonberg reaches into a cage and scoops up a different sort of chimera. It looks like a subway-variety mouse, but its tiny body cradles a partial replica of one of the most intricate systems known to biology: a human immune system. This whiskered fur ball has the extraordinary ability to produce disease-fighting antibodies in its cells that can be harvested and turned into drugs. As the creature sniffs the hand of the scientist that invented her, the 49-year-old Lonberg responds as if he is encountering the animal for the first time. "I find this amazing," he says. The challenge of engineering this rodent is comparable to building a towering skyscraper, he says: "It's amazing that people can create something of this complexity."

This is the story of two scientists, Meade and Lonberg, who are toiling on the fringes of biotechnology. Their paths crossed 20 years ago, setting them on a quest to alter the age-old partnership between man and beast by mixing genes to concoct new medicines. Since then the two have pursued their goal on separate but parallel tracks. Meade, 59, is now chief scientific

officer of Framingham (Mass.)-based GTC Biotherapeutics which created Sweetheart. Lonberg is scientific director at Medarex Inc., which is taking a lead in commercializing transgenic mice.

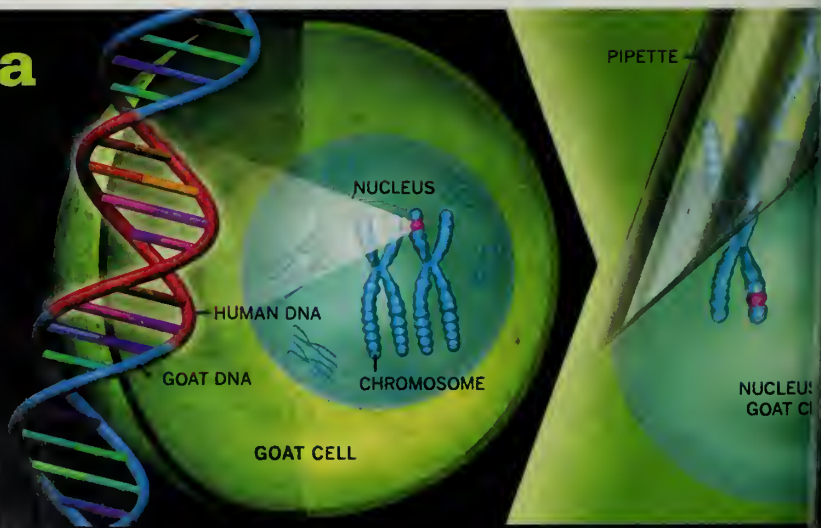
In the business of biotech, chimeras are about as close to science fiction as you can get. People have been crossing critters for centuries—yielding everything from mules to labradoodles. But jumping the gene barrier by giving animal copies of human genes is more sensational. These creature look, act, and smell like animals, yet their cellular machinery conceals unique biochemical capabilities. Already, 50 biotech and pharmaceutical companies are using mice from Medarex to develop treatments for terrible diseases—from malignant melanoma to lymphoma to lupus. And GTC's goats may become factories for drugs that are too complex to produce another way.

Yet as promising as these developments are, Meade and Lonberg strive to hold their optimism in check. Both spend years confronting the skepticism of other scientists, and even derision. Today, GTC and Medarex are burning through cash and investors are getting impatient. Other transgenics companies have shriveled and died. As drug regulators start issuing their rulings in coming months, the two men will learn whether their life's work will enrich mankind's supply of drugs or if their companies will sink into oblivion like so many other promising biotechs.

The saga of the goat and the mouse began in 1984, in a lab at Biogen Inc. in Cambridge, Mass. Meade and Lonberg were brainstorming how to manufacture a human protein that looked promising as a treatment for blood clots. They pulled an all-nighter devising a scheme for slipping human genes into the DNA of animals and then milking them to harvest the drug. The pair thought it was a brilliant idea, but few of their colleagues agreed. When Lonberg described it the next day to then-Chief Walter Gilbert and his management team, they nearly laughed the young scientist out of the room. "Gilbert looked at me and said, 'how about making it in goose eggs? You could have a goose who laid the golden egg,'" recalls Lonberg.

animal pharma how goats get human genes

A variety of complex human proteins could be used as drugs to treat scourges ranging from rheumatoid arthritis to cancer. But some of these molecules are complex and difficult to manufacture in biotech factories. Using genetic engineering, GTC Biotherapeutics is developing goats that make human proteins in their milk.



GENE INSERT A human gene is inserted into the chromosomes of a cell from a goat.

GOAT CLONE Using a technique the one that yielded Dolly the sheep, researchers remove the nucleus from a goat egg and replace it with the new goat DNA to prompt the egg cell to incorporate

In fact, Meade points out, companies are now trying to do exactly that—extract drugs from transgenic chicken eggs. “It sounds incredibly simple,” Meade says, “but everything’s in the details.”

When Meade and Lonberg first began to tackle those details, they found themselves cast in the role of mad scientists. Having left Biogen in 1985, Lonberg was studying transgenics at Memorial Sloan-Kettering Cancer Center in New York. With the help of Meade, who often visited the lab, he succeeded in rejiggering the DNA of mice so they could produce human proteins in their milk. The scientists then rented a woman’s breast pump from a pharmacy in New York and rigged it up to fit their tiny research subjects. “I remember them using this pipetting apparatus and applying it to the mouse nipples,” laughs Elizabeth Macy, Lonberg’s former adviser at the cancer center. When Meade tried to return the borrowed breast pump a year later, the pharmacist was so shocked to hear what it had been used for that he refused to take it back. Meade and Lonberg seemed like biotech’s version of the Odd Couple. Meade, a jock who sometimes bikes 26 miles to work, once attracted a crowd at Biogen by demonstrating the moves he had learned in a break-dancing class. He wore his ke helmet to protect his head as he spun on the floor. The display startled Lonberg, who once ditched a required physical education credit at Reed College. It cost him his bachelor’s degree, but it was a satisfying “act of defiance,” Lonberg says. Having already been admitted to Harvard’s PhD program in molecular biology, Lonberg called the head of the department to make sure the missing degree wouldn’t matter.



LONGBERG
He's making mice more like men

Differences aside, Meade and Lonberg played off each other’s strengths. Meade, the elder, passed on his knowledge of biochemistry and genetics to the young student. And as Lonberg focused his postgraduate studies on the then-embryonic field of transgenics, he taught Meade the intricacies of stitching human genes into animals. Together they co-authored the first issued patent on extracting drugs from milk in 1989.

Contemplating the gallons of milk necessary to make a drug, Meade planned to apply the technology to cows. Having grown up on a dairy farm outside Pittsburgh, he knew his research subject intimately. When the young Meade didn’t have his nose buried in a science textbook, he was milking the family’s herd and hanging out with the 4-H Club and the Future Farmers of America. “I was probably the only person who figured out butterfat

content using a slide rule,” Meade jokes.

At Biogen, Meade wasn’t always confident that his bosses supported his plan to marry biotech with bovines. During analyst meetings, he recalls, “I had this feeling they were trotting me out for comic relief.” He didn’t feel truly in his element until he was managing research at GTC, a company devoted mostly to goat/human chimeras.

The Dolly Difference

IN PRINCIPAL, giving Sweetheart and the rest of her herd the machinery to make human proteins is basic college biology. It’s a matter of inserting a copy of a single human gene into her DNA and programming it to turn on in her mammary gland. But in the early days, GTC’s method for tweaking the goat’s DNA was so clumsy that only 5% of the kids were born carrying the human gene. Over the years, a string of scientific breakthroughs enhanced the process. Topping the list was the sheep called Dolly. After the Roslin Institute in Scotland cloned the now-famous sheep, GTC adapted the technology to its newest breeds of drugmaking goats—boosting the success rate to nearly 100%.

Investors at first went wild over GTC’s goats. In the late 1990s demand for biotech drugs was skyrocketing, and drugmakers faced a dire manufacturing crunch. GTC promised virtually unlimited capacity at a fraction of the \$500 million it costs to build the typical biotech factory. It made perfect sense: You need more drugs? Breed more goats. Even some majors like Bristol-Myers Squibb and Johnson & Johnson began talking with GTC. Investors piled in, pumping GTC’s stock up to \$50, which gave the unprofitable biotech a market value of more than \$1 billion.

This wasn’t sustainable. Drugmakers gradually improved the traditional way of making biotech proteins—in cells housed in giant steel vats. Fears of a biotech manufacturing shortage subsided, and one by one, GTC’s deep-pocketed partners pulled out. In-



FROM HUMAN The newly cell is coaxed to divide and develop into a goat. The cloned goats are passing on their human generations.

PROTEIN POWERHOUSES These goats make human proteins in their milk. As drugs, such molecules could generate hundreds of millions a year in sales, GTC estimates.

(TOP TO BOTTOM) PHOTOGRAPHS BY RICHARD MORGENSTEIN; SHAWN G. HENRY

vestors bailed, too, driving GTC's stock down to single-digit territory. "You don't get many swings at the bat in this business," Meade says. "People lost faith."

But Meade himself remained steadfast. He was certain that his goats could correct a major shortcoming of steel vats—the latter are terrible at churning out complex proteins. Sweet-heart's protein, called antithrombin, is one such molecule. And to this day it can only be harvested from donated human blood, which is often in short supply. So, armed with \$75.7 million from a stock offering GTC pulled off during the 2000

market boom, the company charged ahead on its own. Executives at GTC's former parent Genzyme Corp. were impressed that Meade and his team never seemed to get discouraged. "There were enormous challenges. Some people thought they were crazy," says James A. Geraghty, senior vice-president at Genzyme, which still owns 9.6% of GTC's stock. "But crazy is not that different from passionate."

For Meade's old partner, Lonberg, passion has always come in a small package: mice. As a boy, in Arlington, Va., he took two gerbils his grandmother gave him and bred them into a

What's Ethical And What Isn't?

As Stanford University professor Irving Weissman reflects on his lifelong quest to solve the mysteries of cancer, he bristles at the prospect that his work could be outlawed. A bill sponsored by Senator Sam Brownback (R-Kan.) introduced last spring would make it a crime to place human brain cells in animals. That means Weissman's work—which involves transplanting human brain-tumor cells into mice—could conceivably land the 65-year-old scientist behind bars.

Weissman, who directs a stem-cell research institute at Stanford and also co-founded a company called StemCells Inc., believes that treatments for brain disorders such as Alzheimer's and amyotrophic lateral sclerosis (Lou Gehrig's disease) could emerge from research like his. Experiments on mice with partially humanized brains could shed light on how brain diseases progress. And such animals could provide testing grounds for embryonic stem cells and other methods of regenerating diseased brains. "Tell me, Mr. Brownback, which of these diseases should we not pursue?" says Weissman as he points to a list on his laptop. "There are people whose window of opportunity is very brief to get these therapies. As far as I'm concerned, he's condemning them."

The bill sponsored by Brownback, who declined to be interviewed for this story, is part of a mounting debate about animals that incorporate human cells. Opponents worry that scientists will be tempted to create a whole zoo full of scary creatures—evoking H.G. Wells's 1896 tale of murderous half-human beasts, *The Island of Dr. Moreau*. Others fret that by giving animals human traits, we will somehow alter their moral status—and that's a sin, according to some religions. At the crux of the debate is a single perplexing question: What does it mean to be

human? Says John D. Loike, a bioethicist at Columbia University: "We're entering territory we're just beginning to understand."

Supporters of research on humanized lab animals insist that mere genes—tiny molecules of nucleic acid—do not define human beings. It's the capacity to think, reason, and speak that distinguishes our species, they argue. And what gives us that ability is a whole basket of biological processes involving DNA, RNA, proteins, and a symphony of chemical signals. Most important, it's the complex structure of our brain that endows us with uniquely human powers.

In this context the act of swapping a few genes between species is really not much different than breeding a horse with a donkey to create a mule. "There's a bizarre misunderstanding about the nature of life," says Henry T. Greely, a law professor at Stanford who is advising Weissman on the ethics of his mouse experiments. "There aren't 'human genes' and 'goat genes.' There are just genes that have different functions."

Implanting human brain cells into animals, however, could take researchers onto treacherous ground. The resulting

critters aren't actually transgenic, as the alterations are not in the genes, and will not be passed down through generations. Nevertheless, there are some frightening potential scenarios. In one, altered creatures might achieve consciousness and self-awareness but be unable to communicate their awakening. To prevent the emergence of animals that would rather be debating Sophocles than running on exercise wheels, bioethicists working with Weissman suggest putting experiments on hold if humanized rodents exhibit any starkly unmouse-like brain structure or behavior.

When the lab animal is a close relative to man, ethical concerns are heightened. Last April, the National Academy of Sciences published guidelines advising scientists to avoid implanting human embryonic stem cells into the developing brains of nonhuman primates. Bioethicists at Johns Hopkins University published a paper in the journal *Science* seconding the recommendation.

Both groups suggest setting up oversight committees to review experiments that involve humanized animals. "Society needs to feel comfortable that moral issues are being handled well," says Ruth R. Faden, executive director of the Phoebe R. Berman Bioethics Institute at Hopkins. "For the science to proceed, for the funding to proceed, we must have the confidence of the public." The National Council of Churches USA advocates setting up a governing body to review transgenic and brain-cell experiments. The organization believes the discussion should include both religious leaders and scientists.

Perhaps such committees are inevitable, but many scientists warn that there will be a cost. Stem-cell research in the U.S. is already constrained because of political controversy. Too many meddling hands could strangle the science, warns Evan Snyder, program director and professor at the Burnham Institute in San Diego, who has injected monkeys with human brain cells as part of his research on pediatric brain diseases: "If we're going to make mistakes, isn't it better to discover them in animals rather than having them pop up in your child?"

—By Arlene Weintraub

FADEN No to stem cells in developing brains of nonhuman primates



colony of 56. And Lonberg met his scientist wife in a lab at Sloan-Kettering. "We literally met in a mouse house," he says. He remembers the two of them attending a transgenics conference in 1989, where a scientist announced a new technique for knocking out certain genes in mice in order to make them more like people. "Everyone got up and applauded," he says.

That same year, Lonberg joined a company with an ambitious plan to make mice more like men. Scientists in the early 1980s had already figured out how to produce human proteins in mice. But there was one snag: Resulting products would have bits of mouse protein in them, which would make people sick with side effects.

Ensnared at his new company, called GenPharm, he created and then bred two different varieties of gene-modified mice. One had a disabled immune system—it couldn't produce any of its own antibodies. The other bore the genes that are responsible for making human antibodies. Immunologically speaking, the offspring of these two rodents is more human than rodent. Provoked by a disease-causing agent—bits of a human tumor, for example—"their cells produce antibodies in exactly the right form to go into humans," Lonberg says. The antibodies can then be mass-produced as drugs.

Triumph to Turmoil

WHAT SHOULD HAVE BEEN A TRIUMPH led instead to a period of turmoil. After Lonberg trumpeted his mice at a 1993 conference, rival Cell Genesys filed suit against GenPharm, claiming theft of trade secrets. GenPharm answered with claims of patent infringement. As the battle dragged on, chewing up the company's scarce capital, GenPharm was forced to pare down from 110 employees to seven. Still, amid general despair, Lonberg was determined to keep the technology alive. "We were so sad to see our good team falling apart," says former co-worker Hank Pieper. "One day Nils took us aside and spent a great deal of time explaining why GenPharm was right and how he was going to make sure we came out as winners." Three years later the parties settled. Cell Genesys (now called Abgenix) dropped the theft charge and paid GenPharm \$40 million to cross-license its patents.

Once the legal hurdles were cleared, other biotechs started approaching Lonberg. One company that was particularly interested was Medarex, which like hundreds of other biotechs was pursuing antibodies, but without a distinctive technology that could quickly identify and generate the most promising molecules. "We needed a tool," recalls Donald L. Drakeman, CEO of Medarex. "Nils's transgenic mice gave us that." Medarex bought GenPharm in 1997 for \$62.2 million in stock. And this time, the stock market once again began to smile at biotech after a long slump. In March, 2000, Medarex made a smart move, just as GTC had done. It raised \$388 million in a stock offering. "This changed Medarex," Lonberg says, by allowing it to build a research facility.

BIOFACTORY

Farm animals excel at churning out big, complex proteins that can serve as medicines



As if to remind Lonberg of his ongoing battle to conquer transgenics, a giant framed photo of a mouse stares down at the scientist in his Milpitas (Calif.) lab. Down the hall, more than 6,000 mice live in pathogen-proof rooms, hidden behind double doors. The scientists who wish to enter must first take showers and don cloth gowns from head to toe, to avoid passing along their germs to the valuable and pampered rodents.

But what if the protected mice were the ones that posed the threat? In Greek mythology, the chimera was a hybrid beast that breathed fire and foreshadowed natural disasters. Some experts take that as a metaphor. They worry that transplanted human genes—particularly in farm animals—could "leak" into the food supply, say, if a genetically modified critter were to run off and mate with a non-GM cousin. One of the last things you'd want is a bit of human protein—one that could make healthy people sick—turning up in the goat cheese that's sprinkled on top of your salad. Some people call this the "ick" factor. "Even when you have an ethical ration-

ale for doing this work, people find it troubling," says Michigan State University philosophy professor Paul B. Thompson.

It would help if the regulations meant to prevent nightmarish accidents were actually enforced. Critics blast the Food & Drug Administration and U.S. Agriculture Dept. for failing to tighten regulations that will keep transgenic animals used in health care out of the food supply. Lobbying groups such as the Union of Concerned Scientists (UCS) were dismayed in 2002 when the University of Illinois at Urbana-Champaign sent 386 pigs used in transgenic experiments to slaughter. Only one animal had transgenes, but none of the pigs had been approved by the FDA for commercial use. (None ended up in the food supply.)

To avoid mistakes, GTC has rigorous security protocols. And the farm is hidden on a back road with no signs, to foil animal-rights vigilantes who might want to "liberate" the goats. GTC also designed nibble-proof pens, recognizing that goats have an uncanny ability to open latched doors with their teeth.

Even with such careful measures, there are questions that can't be corralled in electronic fences. As researchers amble fur-

The Transgenic Menagerie

What does it mean to be human? Columbia University bioethicist John Loike tackles that conundrum, and other questions raised by transgenics research, in a video interview

Pigs to the rescue Early attempts to use pigs as organ donors for human patients failed. But a small company, Revivicor, may clear the hurdles by reengineering pigs with human genes.

Cows and chickens and mice, oh my! A slide show featuring the menagerie of critters being genetically altered for the benefit of human health care

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ther out on biology's frontier, they are forcing society to confront what it means to be human, and to consider whether scientists are changing that very definition by so freely mixing the genes of humans and beasts (sidebar, p. 76).

The pioneers of transgenics regard such metaphysical debates as random noise. They argue that a human being isn't defined by individual genes—most of which are common to all animals. "DNA does not contain the soul or consciousness of a person," Meade declares.

For now, he and Lonberg are focusing on a more urgent matter: persuading regulators that their drugs are safe and effective. Their latest clinical-trial data are compelling, the scientists say, but now they are stuck in a waiting game. In September, European regulators said they needed more time to decide whether to approve goat-made antithrombin—disappointing investors who had hoped for an October ruling. CEO Geoffrey F. Cox takes the delays in stride. "Making transgenic animals is very clever, but it's not a business," he says. "We've got work to do." If GTC succeeds, he says antithrombin could someday bring in more than \$500 million in annual sales.

On a crisp October morning, the normally casual Meade arrives for work dressed in a suit. It's his turn to talk strategy with the board of directors. These days, the discussion is no longer confined to antithrombin. GTC has developed herds to produce other drugs, such as a malaria vaccine and a treatment to shrink solid tumors. Even though Meade is approaching the age when others might prefer golf courses to goat farms, he's too energized by the potential of transgenics to leave it behind. One day, he says, he'd like to make goats that can churn out treatments for infectious diseases such as HIV. "The first 20 years of my life I worked on a farm milking cows," Meade says. "The last 20 years I've spent trying to make [transgenics] work. It all kind of ties in."

As GTC inches toward approval of its first goat-made drug, other companies are showing interest in the technology. In July, Boston-based Merrimack Pharmaceuticals expanded a partnership with GTC, which has developed goats that pro-

duce Merrimack's experimental rheumatoid arthritis treatment. "We tried standard production technologies, but they didn't allow us to make it in a commercially viable way," says Robert Mulroy, CEO of Merrimack, who estimates that the drug will address a \$4 billion market.

Medarex can also point to some progress. Of the 40 or so experimental drugs that have been derived from humanized mice, 27 come from Medarex' animals and the rest from rival Abgenix. In November, Abgenix announced that a cancer treatment developed with giant Amgen shrank colon tumors 46% in a late-stage trial. A month later, Amgen scooped up Abgenix for \$2.2 billion.

These developments also vindicate Medarex' work in humanized mice—and it's own close partnership with Amgen. The biotech giant is developing three drugs using Medarex's mice. "It's a highly productive relationship and we anticipate doing further business with Medarex," says Scott Foraker, vice-president of licensing for Amgen. Will Amgen swallow Medarex too? "We are continually evaluating acquisition and licensing opportunities," he says.

Last September, Pfizer Inc. took a stake in Medarex and paid \$100 million up front for rights to as many as 50 antibodies over the next decade. The deal could ultimately bring Medarex \$400 million. And Medarex and Bristol-Myers Squibb are co-developing a drug to treat metastatic melanoma. To remind himself how far he and mice have come, Lonberg often pulls up before-

after X-rays of a patient who received the drug. "He had 31 tumors. They're all gone," Lonberg says. The proof won't come until a pivotal, late-stage trial is completed next year, but Bristol is thinking about using the mice on more drugs.

Lonberg and Meade often catch up on the phone and at conferences. The two share a dream of making a drug together—generating a life-saving molecule in Lonberg's mice, then producing it in Meade's goats. "Harry and I agree it would be a wonderful collaboration," Lonberg says. And a fitting epitaph for a 20-year history of transgenic beasts and human health care.



SUITABLE?
Organs from transgenic pigs could save human lives.

chimeras galore

Scientists are implanting human genes in animals, creating crossbreeds called chimeras. Though sometimes controversial, the work could spark medical breakthroughs

Animal

■ **Pigs** engineered with human genes that help make their kidneys, hearts, and other organs suitable for transplanting into people.

■ **Rabbits** whose blood contains human polyclonal antibodies, therapeutic molecules that may be impossible to make in standard biotech factories.

■ **Cows** that make human polyclonal antibodies in their blood, which can be harvested without harming them.

■ **Chickens** that lay eggs containing human proteins, which may yield biotech drugs at a fraction of the cost of standard production methods.

Status

■ Scientists are breeding pigs with human-like organs, which could keep patients alive for months while awaiting human organs.

■ Therapeutic Human Polyclonals Inc. and Genzyme Corp. are developing a drug to prevent organ rejection in transplant patients. It could address a \$3 billion market.

■ Hematech LLC, owned by Japan's Kirin Brewery, is spending \$100 million on the science.

■ Eggs from poultry engineered by Viragen Inc. and Origen Therapeutics may yield antitoxins and drugs for diseases such as cancer.

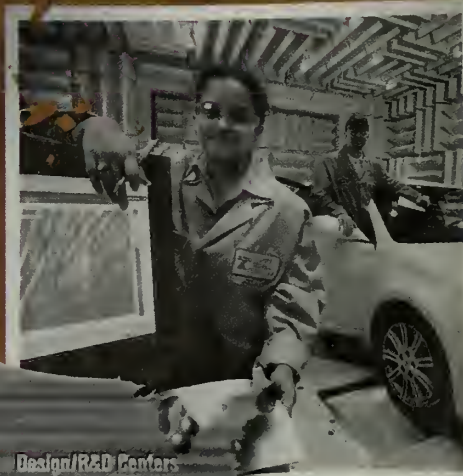


Where we go when we go back to the drawing board.

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Counting the Eyeballs

In the TiVo Age, Mad Ave is turning to services that explain which ads work

BY DAVID KILEY

BY SOME ESTIMATES two-thirds of TV viewers cut the sound during commercials, channel-surf, or skip them altogether because they are annoying or irrelevant.

In fact, if TV commercials were subjected to ratings the way TV programs are, most would be canceled faster than Martha Stewart's *The Apprentice*.

So what did Lee Weinblatt do? The CEO of Tenaflly (N.J.)-based PreTesting Co., figured out a way to scientifically measure ad viewership, much to the concern of the advertising world. By this summer he expects to have 35,000 households in four to seven cities wired with boxes that monitor how audiences respond to ads, both on live TV and in programs taped on digital video recorders (DVRs). Daily "ratings" of TV ads—tallies of how many people are watching or skipping—from the service, called MediaCheck, will enable advertisers to determine quickly whether spots should be yanked off the air or at least switched to other time slots. His digital boxes can even reward consumers for watching ads with giveaways. "TV ads aren't ineffective. Bad TV ads are ineffective," says Weinblatt.

MediaCheck is one of a handful of services emerging to make TV ads prove their worth, in part to answer the challenge posed by Internet ads, whose viewers can so easily be counted by clicks. Advertisers and networks are coming to view ad ratings as a necessary part of competing with the online

ad boom. More important, the new tools will help them put the screws like never before to often free-spending Madison Avenue idea factories. They also stand to wreak havoc on the process of buying and selling ad time.

What accounts for viewers' continue disdain of ads anyway? Clutter and irrelevancy are often blamed. But now ratings are able to cast a spotlight on the quality of ads. "The bigger issue," says David Poltrack, executive vice-president for research and planning at CBS Broadcasting Inc., "is whether the ads are any good in the first place."

HIDDEN BENEFITS

DETERMINING WHAT'S good and what isn't in the world of advertising is getting easier. Besides MediaCheck, Nielsen Media Research now offers advertisers and media agencies a "minute-by-minute" audience measurement, gauging how many viewers stay tuned during commercial breaks. And upstart firm IAG Research Inc. is able to report, by means of the thousands of daily Internet surveys, which programs, product placements, and second ads are watched "most attentively." Advertising based on how big an audience is—counting eyeballs—has become a commodity business, says IAG CEO Alan Gould. "The new currency is measuring engagement," he says.

Early adopters of ad ratings are finding some hidden benefits. Advertisers that have quietly been using IAG's data are able to negotiate smarter deals, cobbling together lower-rated, cheaper programs that add up to a better per-viewer ad buy. Chrysler Group, for example, has advertised on NBC's *Office*, despite rating below Nielsen's top 20 shows. IAG has been

to p



at the comedy show is, most weeks, only slightly behind ABC's top-five rated *Desperate Housewives* in terms of details viewers recall about program plot, product placement, and ads. "We're pursuing any move to get the accountability—the real numbers—on TV audiences that we are getting with our Internet ad buys," says Julie Roehm, Chrysler's marketing communications director.

Weinblatt's MediaCheck service doesn't rely on surveys but rather the massive measurement of what viewers are watching and skipping. MediaCheck's digital box measures how fast viewers skip an electronically coded ad: within 10 seconds, 20 seconds, or 30 seconds. In MediaCheck's five-month test run last year in 2,500 Omaha households, viewers didn't click away or skip ads because of clutter. Instead, "poor executions and the fact that they had seen an ad too many times were the chief reasons," says Weinblatt, whose company has long tested ads with consumers.

One Burger King Corp. franchisee learned some unexpected truths after supplying MediaCheck with coded ads. One featured a fictional rock band called Coq Rock, whose members donned chicken masks. It was a hit with the ad critics—but a ratings bomb. MediaCheck's results showed the ad was viewed by no more than 5.8% of households between 5 a.m. and midnight, vs. an average of 12% to 16.5% of households for a more conventional BK ad tied to a *Star Wars* promotion. "We never had any way of measuring [the] effectiveness of ads before, except for store traffic and our own gut," says Mike Simmonds, CEO of Simmonds

Restaurant Management, which owns more than 70 Burger Kings. After all, if an advertiser pays to reach 1,000 viewers and only 200 watch the ad—and only about half of those recall anything about it—it's not exactly money well-spent. But MediaCheck's fast feedback allowed the franchisee to adjust, running more *Star Wars* ads and fewer Coq Rock commercials.

DATA-HUNGRY

TV NETWORKS, faced with a slower-growing ad future than the Internet, are cautiously signing up. CBS buys IAG data. And sources say ABC and DirecTV Group Inc. are among those negotiating with MediaCheck to encode ads and use the ratings data to attract advertisers thirsty for the insight. The Weather Channel is buying Nielsen's minute-by-minute ratings, including ad breaks, to show advertisers and agencies the payoff of running ads on its channel even though viewers tend to watch for just a few minutes.

Still, ad ratings could upset the decades-old system of pricing ad time based on how many viewers are watching a show and instead force networks to price time based on how many watch the commercials. CBS' Poltrack says a future development for the networks could be charging advertisers who put up poorly rated ads higher prices for airtime than those with better ads, on the premise that bad ads spur viewers to surf to a competing channel. But he acknowledges there's a lot to figure out. Will an advertiser with a high-rated ad on one channel, say, get punished on another just because the same ad follows a poorly rated spot that viewers skip? "You have to be careful what you wish for," says Poltrack.

Madison Avenue, too, is bracing itself. Scott Goodson of agency StrawberryFrog,

Don't Skip My Ads

"Ratings" for TV ads could help networks, cable channels, and advertisers better justify the big money being spent on 30-second spots. But ad agencies are wary, even as they face a future of more ad-skipping technology. The ad landscape today:

\$60 billion

What advertisers will spend this year on TV ads, even as many are increasing spending on the Web and other media where return-on-investment is easier to track

79%

The percentage of people who skip ads and channel-surf during commercial breaks

44%

The projected percentage of households with digital video recorders (DVRs) by 2009

51%

The percentage of TV viewing time accounted for by time-shifted, recorded programming after two years of DVR ownership

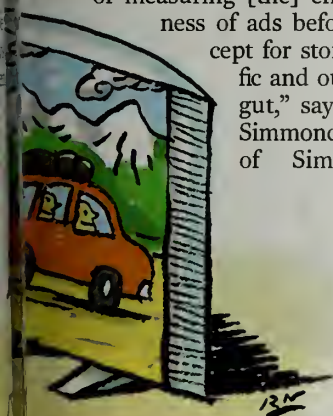
Data: Universal McCann, Mindshare, Lyra Research, Parks Associates

whose clients include Heineken and Old Navy, says ratings could rob commercials of edgy creativity by pushing agencies to produce ads to satisfy a ratings scheme instead of a target audience. "They've been trying to turn advertising into a science for 20 years, and look where it's gotten us," Goodson complains. But Rich Stoddart, CEO of Leo Burnett USA Inc. and former ad chief at Ford Motor Co., says there's no reason why effective, creative advertising can't stand up to ratings. "Knowing how many viewers skip and why will change the economic model of TV advertising," Stoddart says.

For now advertisers and agencies are left with the hard truth that 8 out of 10 DVR buyers took the plunge to avoid ads, according to media agency MindShare. MediaCheck's Weinblatt has a possible solution for that, too. Besides delivering ad ratings, his digital boxes also let an advertiser offer consumers coupons, product samples, or discounts.

The box flashes a light at the TV viewer indicating there is a reward for watching the ad. A few times a week, the consumer can pull a memory stick from the box and plug it into a USB port on a computer. Up pops a list of loot earned by watch-

ing the ads. In the Omaha test, 600 of 2,500 households checked their haul of goodies daily. And 52% of the coupons printed out from the system were redeemed—50 times the national rate for newspaper coupons. Because the box is cheap to produce, says Weinblatt, the system, which essentially pays consumers to watch ads, could be scaled up to millions of homes. If ratings don't force advertisers and agencies to make more compelling ads, just paying consumers for their time could be the next frontier. ■



Companies are using the data to negotiate better per-viewer ad buys



**TO US IT'S A SIGN OF THE SEASON.
IN EARTHQUAKE RAVAGED SOUTH ASIA,
IT'S A SIGN OF CERTAIN DEATH.**

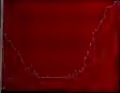
The earthquake was just the beginning. The upcoming winter could kill 3.3 million more. Making it the deadliest natural disaster in history.

Don't leave South Asia in the cold. You can change the forecast.

Please help. Now. Go to: **www.safewinter.org**



**South Asia
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Management

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Tiki Tom

Located in Duluth, Minnesota, the Polynesian-themed waterpark offers a tropical atmosphere and hours of fun! Enjoy the sights of the islands with thatched roofs, warm waters, tiki totems and tropical creatures at every turn. The Edge features:

- 35,000 square feet
- Two four-story slides
- 400-foot-long lazy river
- Vortex pool
- Large play area for young children with several small slides and a huge waterfall bucket that dumps 300 gallons of water every few minutes
- Fun for all ages!

Just as fantastic are the hotel rooms that surround the waterpark. There are 300 to choose from, including two-room suites and kid suites—many with beautiful views of Lake Superior.

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EDITED BY
DAM ASTON

INNOVATIONS

Of bendable
batteries and
inkjet bones

Japan's **NEC** has come up with a superthin, flexible, rechargeable battery that stores its juice in an electrochemically charged gel, and that could one day power e-newspapers or smart I.D. cards. Bendable batteries made of this material could hold as much power as like-sized lithium-ion batteries. The battery can be just

1/100th of an inch thick—about as wide as three human hairs, side by side. NEC says its thin battery can recharge in just 30 seconds. What's more, the gel is

free of harmful heavy metals commonly used in today's batteries. Don't expect it soon, though: NEC hasn't said when it will hit the market.

Inkjet printers may be the optimum tool for building artificial bones. Researchers at Japan's New Energy & Industrial Technology Development Organization and two other institutions recently used such a system to fashion bone-like plates from ultrathin layers of a ceramic substance. Impregnated with living cells and implanted in dogs that had suffered skull injuries, the plates served as scaffolds to support regenerated bone tissue. In producing such scaffolds, the inkjet technique proved much faster than other approaches. Researchers hope to begin human clinical trials in 2006.

—Kenji Hall



DIABETES

BLOOD SUGAR READINGS IN A PAINLESS BLINK OF THE EYE

ONE OF THE BURDENS diabetes patients face is the constant need to monitor their blood sugar by pricking their fingers. Oculir, a San Diego startup, is planning a pain-free alternative. The company is developing a monitor that reads blood sugar levels by inspecting the tiny blood vessels of the eye—without ever touching the eyeball.

The monitor works by bouncing a harmless beam of infrared light off the white of the eye. Although invisible, the spectrum of light in the

probe is just the right wavelength to interact with glucose molecules in blood flowing through tiny vessels in the thin membrane covering the eye. "The light reflected back is proportional to the amount of glucose in the blood," says CEO John Burd.

In December, Oculir raised \$7.3 million in venture capital to fund the studies necessary for Food & Drug Administration approval. Burd says if all goes well, the device could go on sale in 2009. —Arlene Weintraub

MATERIALS

SPRINGING AHEAD IN NANOTECH

THE CARBON NANOTUBE is the wunderkind of the nanotech world. Such tubes—in which carbon atoms make up the walls of cylinders just a few billionths of a meter wide—fascinate scientists because of their unrivaled strength, near immunity to radiation, and unique electrical properties.

To these talents, add super-springiness. Researchers have found that when properly aligned, films made up of "multiwalled" nanotubes—basically, tubes within tubes—

act as tireless springs. Able to collapse to less than 15% of their starting length, the tubes rebound to full size undamaged, says Pulickel Ajayan, a materials scientist at Rensselaer Polytechnic Institute and co-leader of the multi-institution research effort. When the tubes are combined, they create an ultralight foam-like material that's also highly durable. The scientists found the material can be squashed up to 10,000 times and it would still rebound fully, with no fractures or loss of strength.

Next, Ajayan's team is looking at how the material might be used. One possibility: cushioning ultra-fine electronics components.

ENVIRONMENT

MORE TREES, LESS WARMING—AND WATER

TREES ARE KEY weapons in the fight against global warming. The long-lived plants offer a cheap way to capture and lock away tons of carbon dioxide for decades. Thanks to the Kyoto Accord and similar regional efforts, companies in the U.S. and worldwide are already planting countless seedlings—or paying others to do so—to offset their emissions.

For all the benefits they bring, however, big tree plantations can have mixed local effects. A study in the Dec. 23 *Science* concludes that planting trees in open



farm- and grasslands, the sorts of sites most often considered for such projects, can harm local water dynamics. Tree farms retain about 20% more rainwater than do crops or grasses. This can cut the flow of water in streams and lead to the buildup of harmful salts in soil, notes Robert Jackson, the Duke University biologist who co-authored the report. On the plus side, he adds, replacing crops or grasslands with trees can cut pollution from erosion and from fertilizer and pesticide runoff.



How Good Are Google's Extras?

AN ESTIMATED 79 MILLION PEOPLE USE Google's search engine every day, but there's a side of Google you may not know. You can get shopping information, satellite and road maps, photo editing software, and e-mail—all for free. But are these services any good? And how do they stand up to the competition? Our reviewers checked them out, and here's what they found.

BusinessWeek online

For more on Google's search services including its blog search tool, go to www.businessweek.com/extras

1 Snowshoes: All-terrain vehicles for your feet

92 Digital gear for the plugged-in skier

93 Hedge funds: Do your own due diligence

94 Discount days for closed-end funds

FROOGLE

A More Human Touch, Please

FROOGLE'S SHOPPING service, Froogle, has been around for a little more than three years. That's nearly an eternity online. Yet it hasn't caught up with eBay's eShopping, Shopping.com, E.W. Scripps's Shopzilla, and Yahoo! Shopping. Despite offering Google's customary speed and some attractive features, such as the ability to find products in local stores, Froogle can't match the leaders in what really matters: quickly finding just the products you want. The very thing that made Google so popular—a starkly simple home page—doesn't work for Froogle. It sports little more than a search box and a random list of often-obscure products, from “voltmeter” to “mush,” that other users recently found through the site. By contrast, most online mail sites offer category lists on their home pages, often with sample products.

Froogle has some valuable tools, but they have limitations. I tested the site by searching for several products. First up: a “Sony digital camera.” At first glance the Froogle results look useful enough. There's a neatly laid-out list of Sony cameras, with photos, along with several columns of filters so you can choose by price or store or see related searches. Click on a listing and you get a description and rating, followed by stores from which to buy the product, starting with the lowest-priced offering.

The same search on Shopping.com was better, though. You can sort by a wider range of prices, megapixel resolu-

tion, flash function, and other features such as optical zoom. Shopping.com makes you feel as if a digital camera expert consciously set up the right filters.

Next I tested a new Froogle Local Shopping feature that finds products near you. When I typed in “UGG boots near Palo Alto,” Froogle turned up no results, though I knew you could buy UGGs at a nearby mall.

A search for “pashmina shawl near San Francisco” did find a relevant list of stores, almost all in the city, with product descriptions, addresses, and phone numbers. The local listings underscore a unique feature of Froogle: They are accompanied by a Google Map with numbered pushpins showing store locations that you can click on for directions.

Clearly there are better shopping sites. But if Google can apply more human insight to Froogle's solid technical underpinnings, the service is likely to improve.

—Rob Hof

MAPS

It Feels Like You're Flying

LESS THAN A YEAR OLD, Google Maps is threatening to overtake Yahoo! as the No. 2 destination for online maps after MapQuest, and with good reason: Google has introduced such eye-popping features as satellite imagery. More importantly, Google is ahead of the pack in its efforts to integrate maps and local search—an important step toward tailoring results to users' needs.

Google's map product was thrust into the spotlight in April after it integrated its recent maps feature with a satellite-imaging service it acquired in 2004. Users can toggle between traditional maps and a satellite picture. Search for your house, say, and you can zoom in close enough to see the chimney. (Such images are neither live nor updated often.) Google also one-upped rivals with features you can drag: Move the map into

areas that are off-screen and then home in on your destination. Most competitors use cumbersome arrows to move the map in the direction you want, and often a flurry of clicks is required.

Key to the success of Google Maps is its tight integration with local search. Type in “pizza Fergus Falls, MN,” and Google will return a map dotted with red flags. Search results next to the map correspond to each flag. Scroll over the flag to get information about the establishment, including driving directions, a link to reviews, and possibly a Web site.

Yahoo and MapQuest also intertwine their maps with local results. But Google has a slight edge on both.

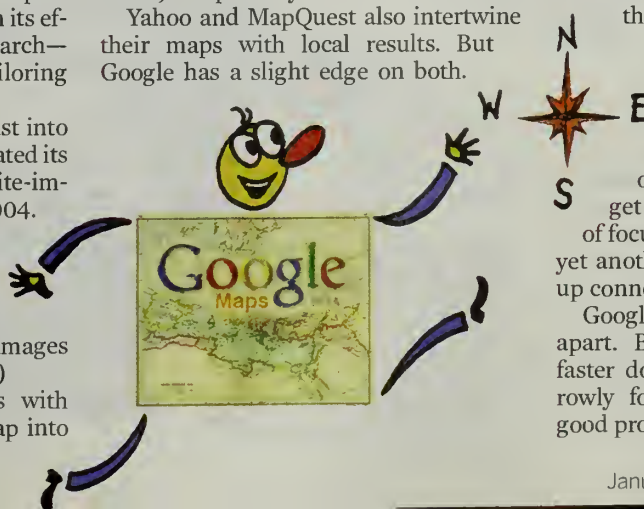
MapQuest falters by not offering that next level of local information. You can't click on the names of the businesses, for example, to find their hours of operation or a link to a Web site. Yahoo's beta version serves up more information but requires another step to get the same results.

One of Google's biggest flaws is the sheer size of its maps, which measure roughly 8.5 inches by 5.5 inches. What's more, the default zoom can be too broad. When I typed in “sushi Palo Alto,” the map went from Morgan Hill to San Francisco—a span of 70 miles. Sure, the right restaurants were flagged in the middle, but 80% of the map was useless. A similar search on MapQuest returned a map that covered just a few miles. It takes only one click on the zoom button to get Google's map to the right level of focus. But the prospect of reloading yet another hefty image using my dial-up connection was daunting.

Google's innovations set its mapping apart. But some tinkering, including faster download speeds and more narrowly focused images, would make a good product even better.

—Ben Elgin

Froogle



EMAIL

Clever But Cluttered

GOTTA GIVE GOOGLE credit. It rethought e-mail down to its roots to create Gmail, which does away with folders and entrusts organization to what Google does best: search. The service now offers a generous 2.6 gigabytes of storage space, virtually eliminating the need to erase messages. When you trade e-mails with someone, Gmail makes it simple to follow the thread of the conversation.

The funny thing is, I rarely use my Gmail account. The service is clever but weird. And the soon-to-be released Yahoo



e-mail blends the good features of Gmail with a more traditional approach that I find comfortable. Just looking at the Gmail inbox takes getting used to. For example, both the e-mails you send and those you receive are tagged "me."

And all of the e-mail traffic is piled together in the same box. It's an eyesore. The best way to deal with this is to tag and archive the e-mails. Gmail's tagging system works better

than traditional folders because you can cross-reference. So if you get an e-mail from your sister about your father, say you can tag it with "father" and "sister" and find it in both bins. Of course, in true Google fashion, you can rely on the search box. It's quick and accurate.

Compared with Gmail, the new Yahoo service is a throwback to classic e-mail. But it feels more like a desktop setup such as Microsoft Outlook, than a Web tool. It's a cinch to drag e-mails into folders, and the pages feel more substantial than traditional Web-mail pages. Like Gmail, Yahoo's mail includes an excellent search function. Both systems provide a glimpse into each document, allowing you to peek at the content.

Gmail is free to everyone as long as you're willing to provide a mobile phone number. (Google, looking ahead to mobile search, clearly wants that database of wireless phone numbers.) For those with the inclination to tinker with it, Gmail is worthwhile—and a handy place to store loads of digital data. —Stephen Bar

PICASA 2

Blurry Around The Edges

IT'S A SEDUCTIVE piece of photo software: The design of Google's Picasa 2 is fantastic, especially compared with the clunky programs that come with your digital camera. The user interface is slick, and the windows and menus are elegant. And subtle animation in basic features—photos spin around smoothly when you rotate them, for instance—makes playing with Picasa a pleasure.

Would that the program's substance matched its aesthetic. While Picasa does a competent job with basic editing and organizational tasks, its photo-sharing is cumbersome, and it lacks advanced editing features.

When you start it up, Picasa offers to scan and grab all the photos on your hard drive. This feature works quickly, and it found photos buried deep in my computer that I had forgotten. Images are sorted by folder, but they can be dragged and dropped into different folders. Or you can create special albums by dragging images into the "photo tray" at the bottom and labeling them together.

Basic editing is a breeze. It's easy to zip through your collection to crop photos, correct red eye, and straighten slanted images. You can tweak light and shadow levels as well as color saturation. Hit the "I feel lucky" button, and Picasa automatically adjusts the light and color—and it works better than "auto-fix" features on other photo software and sites.

Beyond the basics, Picasa is heavy on what I'll call "mess around" features. These are fresh, different, and fun to play with but low on practicality. A prime example: Picasa's Timeline, which displays all of your photos in a moving train of thumbnails that curves around the

screen. Cool? Extremely. What would you use it for? I haven't the faintest idea.

Picasa also offers the option of ordering prints and sharing photos. The "ordering prints" button directs you to Snapfish, Shutterfly, and other sites where Picasa will automatically upload the photos you choose. Then the user designates which photos to want to see. You can send the photos as an e-mail attachment, or you can

"Hello," an instant-messaging application that lets you display photos while you chat with friends.

This is where the service falls short. Why manage photos on Picasa only to have to sign up with another site for printing? If you want to share, sending a dozen photos in one e-mail attachment is a hassle for recipients. And while Hello is a novel idea, it requires recipients to go through a cumbersome sign-up process to gain access to your photos and they must log on each time they want to see what you share.

I would recommend Picasa for those who are interested in basic editing and organizing photos on their hard drive. Practical uses beyond that, such as ordering and printing, head to the specialized photo sites. —Burt



Bigfooting The Winter

The latest gear makes snowshoeing fun for anyone who can walk. **BY LAUREN YOUNG**

IF BAD KNEES HAVE forced you to hang up your skis, or you want an easy way for the whole family to get outdoor exercise this winter, just strap on some snowshoes and start walking. Snowshoeing is booming because it doesn't require a lot of skill, says Nate Goldberg, product manager of the Nordic Center at Beaver Creek Nordic Sports Center in Vail, Colo. Plus, snowshoe manufacturers are producing cool gear that takes advantage of the latest technology to add traction, stability, and comfort.

New models are constructed of lightweight aluminum and molded plastic, and, unlike the old versions, which look like tennis racquets, modern snowshoes offer traction. Stainless-steel front and rear grips, known as crampons, help you navigate steep, slippery ascents and descents. High-end models also feature ergonomically designed suspension systems so you can walk through the snow with a minimal effort. Atlas' spring-loaded snowshoes (\$249 and up) let your feet move from side to side while keeping your heels in place. Weighing about four pounds per pair, they don't feel like heavy leeches as you climb uphill.

Snowshoes are tailored for backcountry expeditions, hiking, or racing. To find the right model, consider the terrain. If you'll be walking around a local park or golf course, try the Tubbs Alti-

tude 30 Snowshoes (\$225), which are designed for day hiking. If you plan to snowshoe at a ski resort or Nordic center, an all-terrain version such as the Atlas 10 Series (\$249 for women, \$259 for men) will help you traverse the varied snow levels of steep hills and allow for natural footing on uneven terrain. "They are really easy for just about anyone to use," says Nancy Cooke, marketing director at Lone Mountain Ranch in Big Sky, Mont., which offers Atlas snowshoes to guests. You can put kids in snowshoes as soon as they can walk, but usually they don't have the stamina to enjoy the sport for extended periods until age five, Cooke says.

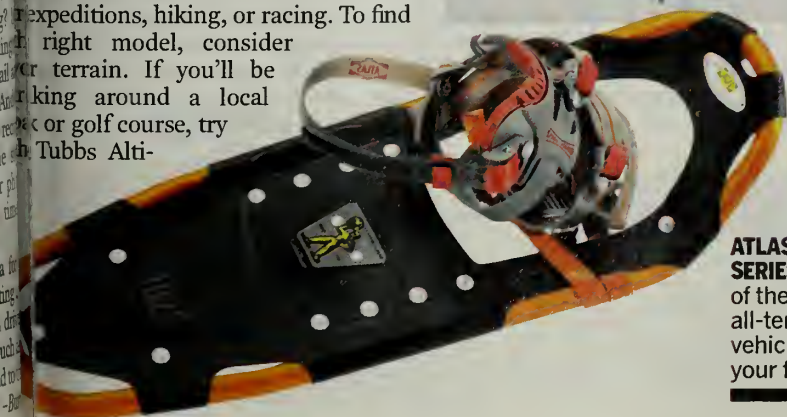
Test a pair before you buy. At sporting goods store REI, rentals cost \$25 for the first day and \$5 for each additional day. (REI offers snowshoeing workshops, too.) Ski resorts also offer rentals.

Experts suggest using poles to prevent sliding and gliding on ice-packed snow. Poles also give you an upper-body workout. Beaver Creek's Goldberg likes Leki's, which adjust to your height. A set of Leki Ultralite Ti Air Ergos retails for \$150. Be sure to put those plastic disks called baskets (about \$6 a pair) a few inches from the tips of the poles to keep them from sinking too far into the snow. Look for a comfortable grip, and avoid downhill and cross-country poles, which are too long for snowshoers.

To keep your toes toasty, you'll need good winter boots or a pair of lightweight, waterproof hiking boots lined with Thinsulate. Leki marketing manager Lindy Spiezer, who leads snowshoe tours in the Buffalo (N.Y.) area, recommends Vasque boots. "I've had dozens of people try them, and they tend to fit everyone well," Spiezer says. The \$100

Vasque Spindrift model is a good choice.

What else do you need? Bruce Carey, a defense lawyer in Eagle County, Colo., and a snowshoe guide at Beaver Creek, is a fan of dressing in layers: He wears glove liners with heavy mittens and favors shirts made of SmartWool, which is less itchy than regular wool. He tops those off with a sweater and a waterproof shell jacket. "You shed clothing depending on your need," Carey says. Studies show that snowshoeing burns 420 to 1,000 calories per hour, so you'll shed pounds, too. ■



ATLAS 10 SERIES Think of them as all-terrain vehicles for your feet



CHAIRLIFT CHAT
Cell phones
abound on the
slopes

and a volume control on the cord. A shortcoming of music on the slopes is that you're cut off from your ski buddies. I found myself pressing the beanie's mute button at the end of every run so I could chat with my wife on the chairlift going back up the mountain.

Still, beanies don't break the ski speak. If you want to hear your music in style, pick up a pair of Oakley's Thump 2 sunglasses. Like the original Thumps that appeared a year ago, the Thump 2s hold digital tunes in the earpieces—but this one carries more music. And five touch buttons on the frames—two on one side, three on the other—let users start and pause

songs, move ahead or back one song, and control the volume. The 240-song model runs \$449. If you can make do with 10 songs, the price is \$299, and the 60-song unit goes for \$249.

Oakley has brought another bit of technology to skiers with its RazrWire shades, developed in partnership with Motorola. Pop on these \$295 sunglasses, attach a small module to the frame's earpiece, and you can make calls. The module, which has a tiny microphone on one end and a speaker that fits into your ear on the other, uses Bluetooth wireless technology that connects to a cell phone that also uses Bluetooth stashed in your parka. The Motorola Razr phone I tested had voice dialing, so soon after I pushed a button on the module and said, "Ray," my buddy was jabbering in my ear. But when I skied and talked at the same time, all Ray could hear was the wind rushing over the microphone.

Another drawback: The RazrWire don't play music. And the Thump 2s can't use Bluetooth. So if you want to make phone calls between songs, you need two sets of glasses. Clearly, Oakley and Motorola are one step ahead of me. On Jan. 10, the companies announced the Oakley R sunglasses that take phone calls and

The Digital Schusser

Headphones in hats, cell phones in sunglasses. It's skiing in the 21st century. **BY JAY GREENE**

SKIING ONCE TOOK YOU AWAY from it all. The only sounds were the wind whistling through the trees and the shush of skis carving turns in the snow. These days, more skiers are bringing the modern world with them to the slopes. Snap a gadget the size of a pack of gum on sunglasses, for example, and you can call anywhere in the world without having to whip out your phone. Strap a cookie-size GPS gizmo on your sleeve, and you can find your altitude and the speed at which you're zipping down the mountain.

Purists may sneer, but some gadgets

can make skiing more fun. So on a recent trip to Washington State's Crystal Mountain, in the shadows of Mt. Rainier, I packed a bevy of ski gizmos and became a cyber-Bode Miller.

iPods are familiar on the slopes. But Burton, maker of trendy snowboarding gear, has come up with a way to tune in without having to worry about earphones popping out each time you hit a mogul. Burton's R.E.D. Ordinance Audex Padded Hat (\$60) builds in high-quality headphones that connect to any audio device. There's a one-touch mute button in case you actually want to talk to someone

The Latest In **Gizmos**

Electronics can enhance your fun on the slopes



NO-HANDS CALLING

RazrWire shades at \$295 have a small module attached to the earpiece

ARMBAND GPS

The Navman Sport.Tool A300 shows your altitude, speed, and distance



music. You'll have to wait until next summer to get them.

If you want to know when a storm is coming, a barometer can help. Suunto, the Finnish maker of high-end sport watches, puts one inside its \$329 S6 ski watch. That's not all. The watch includes an altimeter and a clinometer, which measures the slope's angle. Put that together and you can figure out how fast you're going and how far you've gone. Still, the watch is a tad complicated and takes some effort to understand all its features. But once you can connect the watch to a PC so you can log your performance and measure it against other S6 wearers at Suunto's Web site. Oh, yeah—the watch also tells the time.

LIGHTS, CAMERA, ACTION

IF YOU WANT A BIT more exactitude, try Navman's Sport.Tool A300. The unit, which straps around your arm, is bulkier than the S6. But it uses GPS technology to measure altitude, speed, and distance. The only real drawback with the A300 is that you can't download the data to keep track of performance over long periods. It's hard to beat the price, though. Navman introduced the A300 in the spring for \$179. Now a little long in the tooth by tech standards, it can be found online for as little as \$76.

Of course, the best way to capture all the fun on the slopes is with a camera. As an alternative to hauling around a digital recorder, Oregon Scientific has come up with a way to lash one onto the top of a ski helmet. Its \$120 ATC-1000 is a 1.5-inch tube with a tiny camera and microphone at the end. The camera stores up to ten minutes of video at its highest resolution setting, but users can add an hour or more of storage by inserting a second digital memory card in the device. Video quality: just O.K. I grabbed footage of my 7- and 10-year-old boys sliding down the slopes. It wasn't quite the quality of snow sports filmmaker Warren Miller. But it's a top-rated production in my house. ■

AS UP

in
ATC-
on
in a
records
Neos



Do-It-Yourself Due Diligence

A little sleuthing online can turn up information that may signal trouble ahead. **BY ANNE TERGESEN**

HEDGE FUNDS GENERALLY don't make it easy for investors to get information about their inner workings. But the 80-odd investors in the most recent hedge fund to collapse, tiny HMC International Fund of Montvale, N.J., could have saved themselves trouble and money simply by using the Internet to do some due diligence on HMC's managers.

One, Bret Grebow, left a trail of legal problems that include a property lien, an arrest on charges of possessing drug paraphernalia, and failure to repay much of a loan to a former employer.

Grebow and co-manager Robert Massimi now face Securities & Exchange Commission charges of securities fraud and the misappropriation of more than \$5.2 million of the \$12.9 million invested in HMC. The managers "sent investors false monthly account statements that portrayed their investments as profitable when, in reality, Grebow was systematically looting the Fund's trading account," the SEC alleges in a Dec. 21 complaint filed in the Southern District of New York. Among the items the duo is alleged to have paid for with investor funds are rent and furniture for a Manhattan apartment.

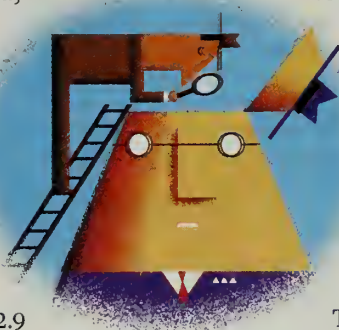
What warning signs were detectable? A search of public databases—including those maintained by Google, LexisNexis, and various federal, state, and county courts—dredged up enough dirt on Grebow to cause alarm. The record includes

arrests in 1994 and 1995 in Arizona—where Grebow attended college, according to HMC's Web site—on charges of possessing marijuana and drug paraphernalia and damaging property worth less than \$100. According to the Pima County Justice Court in Tucson, the drug-related charges were dismissed in July, 1996. Grebow pleaded guilty to a lesser charge—unlawful acts regarding alcohol—and was fined \$284. According to the court, there is an outstanding warrant for Grebow's arrest on the damage charge because of his failure to complete a drug education course. "It was staggeringly

easy to get this information," says Michael Allison, CEO of International Business Research of Princeton, N.J., a company that performs background checks on hedge funds and managers (Personal Business, Nov. 21, 2005).

That's not all. In 2002,

Grebow's former employer, defunct New York brokerage Bluestone Capital, won a judgment against him for not repaying a loan of more than \$118,000, says Eric Streich, an attorney who represented Bluestone. Grebow has since repaid \$3,212, he says. Court records also show an October, 2004 judgment against Grebow for failing to pay his former wife, Jamie Grebow, some \$127,000 in support. An attorney who represented Jamie Grebow didn't return calls. Bret Grebow's attorney declined to comment on the SEC charges or his client's past. With hedge fund blowups becoming common, do some sleuthing before you write a check. ■



Discount Days for Closed-End Funds

A glut of new ones worsened yearend slides. But that means you might find a deal. **BY AARON PRESSMAN**

CLOSED-END FUNDS ARE a quirky lot: They look like mutual funds but are bought and sold like stocks. Depending on market conditions, they trade at prices that are different from the value of their holdings, often at discounts. Typically, the discounts deepen late in the year as shareholders dump their losers to generate tax losses, but the recent selling season turned out to be one of the worst in years—and the New Year's bounce-back could be much muted or delayed.

Why? A glut of new funds. Over the last year investment banks and fund managers raised an estimated \$21 billion in initial public offerings for 46 new funds, many of them copycat products. With underwriting fees of as much as 7%, they're lucrative—and far more profitable than encouraging a client to buy a similar existing fund that trades at a discount.

Investors who bought fund IPOs are getting hit hard. In one case, the Nuveen Equity Premium & Growth Fund, which buys stocks and sells options to generate income, launched at \$20 a share on Nov. 23 and had fallen to \$17.25 by Dec. 30, while the net asset value declined less



than 5%. All but two of the funds launched in 2005 are at discounts.

The flip side of this, of course, is that for those buying now, these discounted funds can be profitable. "We make half our profit for the entire year buying [in December] and selling in January and February," says Thomas Herzfeld, who has followed the

sector for almost 40 years and whose eponymous firm is devoted to investing in closed-end funds.

Some of the biggest markdowns are in funds that invest in bank loans or dividend stocks or produce income by selling options. Equity funds as a whole are trading at a discount of nearly 11%, according to fund-tracking firm Lipper. That's the biggest discount in four years. The average bond-fund discount is 7%, the largest in five years. Bond funds are hurting not so much from new issuance as from higher short-term interest rates, which force the many leveraged funds—which borrow money to buy additional bonds—to cut their payouts. With the flat yield curve raising fears of recession, many investors are shunning funds that buy lower-quality issues.

CUTTING THE DISCOUNTS

THOSE HIGH-YIELD and bank-loan funds are good places to look for bargains, say closed-end watchers. High-yield funds, trading at slight premiums as recently as September, now have an average discount of 11%, pushing their yields close to double-digits. Herzfeld recommends some of the funds trading at the deepest discounts, such as Prospect Street High Income Fund, selling at a 17% discount and yielding almost 9%. The big discount, he says, can act as a cushion to lessen the blow of any decline in bond prices caused by the slowing economy. Bank-loan funds also carry an average discount of 11%. Most invest in floating rate loans so that as rates go higher, yields increase. "They're less risky than so people seem to think," says Don Cassio, senior research analyst at Lipper.

Herzfeld is keeping an eye on the dozen funds formerly run by Citigroup's Smith Barney unit that were sold to Legg Mason on Dec. 1. Institutional shareholders lobbied all year to get the funds to steps to reduce the discounts, such as buying back shares or making a tender offer, but except in one case, Citi did not. Expectations are that Legg Mason will more shareholder-friendly and give the funds a boost.

The best thing that could happen for fund investors is for Wall Street to cranking out the IPOs. "How can you offer a new fund when the old funds are cheap?" says Mariana Bush, a fund analyst at Wachovia Securities, noting three deals slated for December postponed. Maybe investment banks are finally getting the message. ■

Before You Pony Up...

IGNORE pitches to buy new closed-end funds and instead look for similar funds trading at a discount to net asset value. Web sites such as ETFConnect.com provide data about fund strategies and discounts or premiums.

AVOID unnecessary taxes. Buy after the fund has distributed capital gains for the year.

EXAMINE a fund's prospectus for mandatory share repurchases, tender offers, or other features that may help narrow discounts.

DIVERSIFY across asset classes. Bond funds are hurt if rates rise, high-yield and bank-loan funds lose in credit defaults, and equity funds have all the risks of stocks.

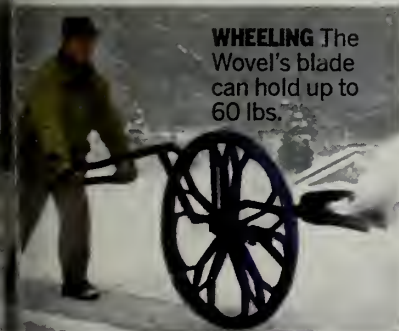
EDITED BY TODDI GUTNER

ADGETS

NOW HOVELING MADE EASY

FOR SOME, shoveling snow is nothing more than a brisk morning workout. But for many others, all that bending, lifting, and twisting may lead to back problems—or worse. Not with this bird-looking snow shovel. Wovel (rhymes with shovel) is the latest in ergonomic shovels that make moving white stuff easier on your body. It has the usual handle and blade, but in between is a wheel three feet in diameter that turns the Wovel into a wheelbarrow. That lets you use your body weight rather than muscle power to push slush and snow. The polypropylene blade measures more than two feet wide and will hold up to 60 lbs. It's \$120, plus \$20 shipping, at wovel.com.

—Larry Armstrong



WHEELING The Wovel's blade can hold up to 60 lbs.

INVESTING

YOUNGER BABY BOOMERS favor hedge funds, private equity, and other alternative investments more than older boomers. So says a 2005 Spectrem Group survey of nearly 1,000 investors with at least \$500,000 to invest. Those in the 40-45 group held a greater percentage of alternative investments than those 46 and up. Spectrem estimates 85% of the estimated 700,000 households in the younger group have the riskier investments. It makes

	HEDGE FUNDS	PRIVATE EQUITY	PRIVATE PLACEMENTS	FUTURES	RESTRICTED STOCK	STOCK OPTIONS
45	33%	30%	18%	15%	30%	33%
60	18	22	18	9	22	31
70	15	15	7	3	14	19
	14	16	12	6	13	12

Spectrem Group

sense: Facing longer life spans and low returns in traditional assets, they've got to seek higher returns.



PROFITS

Pro Forma Puffery

NOW THAT COMPANIES MUST deduct the cost of employee stock options from earnings on their income statements, many businesses are highlighting in their quarterly earnings releases an unofficial, or "pro forma," version that ignores those pesky costs. Some are going further. Tech companies Entegris and Linear Technology each show numbers on their releases that ignore the cost of restricted stock, too.

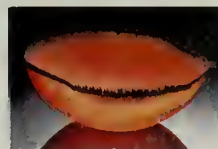
With restricted stock grants growing—up 13% for Standard & Poor's 500-stock index companies in 2004 and 74% in 2003—more may adopt this practice, says Jack Ciesielski, publisher of *The Analyst's Accounting Observer*. That would make comparing pro forma and past results difficult. Steve Cantor, Entegris director of investor relations, says his company issued a lot of restricted shares to retain executives following a recent merger. The expense "was large and unique enough that we wanted to call it out," he says. Linear's chief financial officer, Paul Coghlan, says the company's pro forma earnings illustrate the impact on earnings of new accounting rules that cover stock options and restricted stock. —Anne Tergesen

TIME OFF

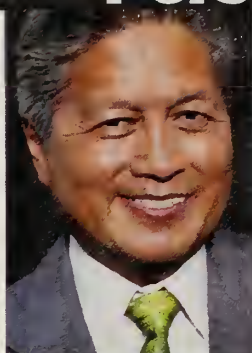
BOWLED OVER IN DETROIT

WHO NEEDS

football? The Detroit Institute of Arts (dia.org) is kicking off its own Super Bowl event a week before the gridiron spectacular comes to the Motor City. The multimedia show, which runs through Apr. 30, features prints, drawings, and photographs of bowls along with a variety of three-dimensional objects, including tureens and vases. Best of all: no beer commercials. —Monica Gagnier



(CLOCKWISE FROM TOP) ILLUSTRATION BY KEN ORVIDAS; COURTESY THE DETROIT INSTITUTE OF ARTS



BY GENE G. MARCIAL

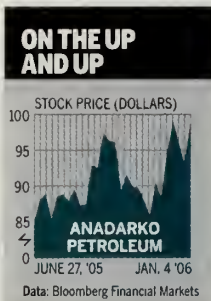
ANADARKO'S HUGE OIL RESERVES MAY BRING A BID FROM RIVALS

FREIGHT TRAINS GO BARRELING ALONG AT GENESEE & WYOMING

THE FBI MAY BE SCOUTING A COGENT FINGERPRINTING CONTRACT

Eager Eyes on Anadarko?

WITH CONOCOPHILLIPS' acquisition of Burlington Resources in December—following Chevron's purchase of Unocal in August—some savvy pros are pointing to Anadarko Petroleum (APC) as the next likely oil target. A large U.S. oil-and-gas explorer-producer—mainly in Alaska, Louisiana, Texas, and the Gulf of Mexico—Anadarko is “an ideal buyout for the bigger oils that need to boost their reserves,” says Fadel Gheit of securities outfit Oppenheimer. He believes Anadarko is being courted by several majors, which he didn't want to name. Although its stock has risen from 80 in June to 98 on Jan. 4, Gheit figures it's still way undervalued. He thinks Anadarko's 2.4 billion barrels of reserves are worth \$30 billion, or \$130 a share, based on a price of just \$15 a barrel. (Chevron, he estimates, paid \$18 a barrel for Burlington's reserves, and Burlington's stock had already gone up from 40 to 77 in a year before Chevron bought it at 88.51 in cash and stock.) Anadarko trades at just 7.6 times Gheit's 2006 estimated earnings of \$12.80 a share, vs. 2005's estimated \$10.30 and 2004's \$7.20. Don Schreiber Jr., CEO of Wealth Builders, which owns stock, says huge oil-and-gas reserves and free-cash flow of more than \$1 billion make Anadarko both a takeover and a value play. With the oil biggies flush with cash and their stocks on the rise, they are looking hard to acquire assets in the ground. Anadarko was featured in this column on Mar. 7 when it was trading at 70.



All Aboard the Genesee & Wyoming

WITH THE ECONOMY ON TRACK and with coal and iron ore in hot demand, little-known regional railroad Genesee & Wyoming (GWR) is riding high. Its Big Board-listed stock has chugged up from 27 in June to 38 on Jan. 4. Smart acquisitions and efficient use of assets have delivered steady sales and earnings growth in the past five years. “There is more upside ahead” for this short-line freight carrier—the second-largest regional railroad in North America, says Richard Steinberg, president of Steinberg Global Asset Management, which owns shares. He sees the stock hitting 45 in six to eight months and 60 in 18 months.

Genesee, which transports coal, ore, petroleum, grain, and forest products in North America, Australia, Bolivia, and Mexico, earned an estimated \$1.76 a share in 2005, vs. \$1.45 in 2004, figures Steinberg, and should earn \$2.11 in 2006. Genesee has offset the hike in fuel prices by cutting operating costs. A healthy balance sheet gives it ample opportunity for more acquisitions, notes Art Hatfield of Morgan Keegan, who rates Genesee “outperform.” Its growth prospects are looking very good, he says.



Cogent Reasons To Buy Cogent

BUSINESS AT COGENT (COGT), a provider of automated fingerprint and other biometric identification gear to law-enforcement agencies, has been on a tear: Sales vaulted from \$13 million in 2001 to \$88 million last year—and are estimated to have nearly doubled, to \$160 million in 2005. But the stock has been in a downspin since August when it was at 33. Now at 25, the stock was hit when Cogent failed to win some contracts in Latin America. But the drop, says Marion Schultheis, managing director at J. & W. Seligman, is a classic buying opportunity thanks to Cogent's long-term growth potential. She expects it to win new contracts this year. Cogent, she notes, has a chance to be awarded a part, if not all, of a major four-year biometric upgrade at the FBI valued at several hundred million dollars. Julie Santoriello of Morgan Stanley, who rates the stock “overweight,” notes in a report that she sees \$203 million in new contracts in 2006. She expects Cogent sales to jump to \$251 million this year. Some 66% of Cogent's estimated 2006 sales are already booked, she says. She figures Cogent earned 71¢ a share in 2005 and should make 95¢ in 2006, up from 38¢ in 2004.



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

The Granddaddy of all ETFs.

Since their launch in 1993, exchange traded funds (ETFs) have become one of the world's fastest growing investments. It all started with Spiders (SPY), the first of the species. As powerful as ever, Spiders still have the highest market value among the more than 200 ETFs that exist today. Each Spider puts the strength of the entire S&P 500® to work in your portfolio. That's 500 of America's leading companies in every share. Spiders are tax-efficient and have low management fees. Like stocks, they can be traded all day long, are subject to similar risks, and, of course, your usual brokerage commission applies. This granddaddy's been around, but can still add some muscle to any portfolio. **www.SPDR.com. Ticker symbol Amex:SPY. The entire S&P 500 in every share.**



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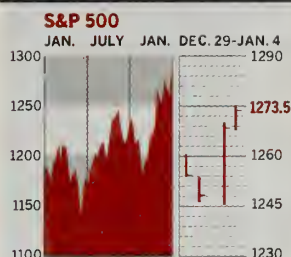
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An investor should consider investment objectives, risks, charges and expenses of the investment company carefully before investing. To obtain a prospectus, which contains this and other information, go to www.SPDR.com or call 1-800-843-2639. Please read the prospectus carefully before investing. Since inception in 1993, the SPDR Trust has distributed only \$0.16 in short and long-term capital gains. S&P 500® and SPDR® are trademarks of The McGraw-Hill Companies, Inc., licensed for use by State Street Global Markets, LLC. SPDRs are not sponsored, endorsed, sold or promoted by Standard & Poor's and S&P makes no representation regarding the advisability of investing in SPDRs. ©2006 State Street Corporation ALPS Distributors, Inc., a registered broker-dealer, is distributor for the SPDR Trust, a unit investment trust. SPD000101

Personal Business Figures of the Week

STOCKS



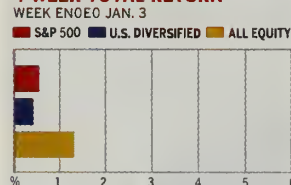
COMMENTARY

Energized by signals that the Fed's string of rate hikes might soon end, stocks roared out of the box on Jan. 3, the first trading session of 2006. In a single day, the NASDAQ beat its return for all of 2005. But investors shouldn't get too excited just yet: some market mavens believe the Fed has three quarter-point increases left, which would put fed funds at 5%, from 4.25% now.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	JAN. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1273.5	1.2	2.0	7.2
Dow Jones Industrials	10,880.2	0.8	1.5	2.3
NASDAQ Composite	2263.5	1.5	2.6	7.4
S&P MidCap 400	754.1	1.3	2.2	17.5
S&P SmallCap 600	358.2	1.2	2.2	12.9
DJ Wilshire 5000	12,756.9	1.3	2.1	9.2

SECTORS

	JAN. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	764.6	2.3	3.1	10.9
BW Info Tech 100**	394.8	2.8	3.8	8.6
S&P/BARRA Growth	609.3	1.2	2.1	6.6
S&P/BARRA Value	659.7	1.2	1.9	7.7
S&P Energy	390.8	4.5	4.9	40.7
S&P Financials	432.6	0.9	1.5	6.7
S&P REIT	157.1	1.5	2.7	11.6
S&P Transportation	250.4	-0.6	0.2	6.4
S&P Utilities	162.9	1.5	2.0	17.4
GSTI Internet	207.8	-0.4	1.3	22.7
PSE Technology	856.4	1.2	2.4	14.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	JAN. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1575.8	3.6	4.2	14.1
London (FT-SE 100)	5714.6	1.6	1.7	17.1
Paris (CAC 40)	4838.5	1.7	2.6	25.1
Frankfurt (DAX)	5523.6	1.4	2.1	28.1
Tokyo (NIKKEI 225)	16,361.5	1.0	1.6	42.1
Hong Kong (Hang Seng)	15,200.1	0.7	2.2	8.1
Toronto (S&P/TSX Composite)	11,501.5	2.1	2.0	25.1
Mexico City (IPC)	18,669.2	5.5	4.9	46.1

FUNDAMENTALS

	JAN. 3	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.78%	1.78%	1.93%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.4	18.4	20.0
S&P 500 P/E Ratio (Next 12 mos.)*	14.7	15.1	16.1
First Call Earnings Surprise*	9.51%	1.58%	7.90%

*First Call Co.

TECHNICAL INDICATORS

	JAN. 3	WEEK AGO	READ
S&P 500 200-day average	1210.9	1209.6	Positive
Stocks above 200-day average	64.0%	62.0%	Neutral
Options: Put/call ratio	0.72	0.70	Positive
Insiders: Vickers NYSE Sell/buy ratio	3.92	3.96	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Gold Mining	24.9	Oil & Gas Refining	97.9
Divsfd. Metals & Mining	11.6	Oil & Gas Exploration	81.4
Oil & Gas Drilling	9.4	Divsfd. Metals & Mining	74.4
Agricultural Products	8.5	Oil & Gas Drilling	72.1
Pharmaceuticals	7.7	Oil & Gas Equipment	65.2

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Furnishings Rtlrs.	-15.8	Automobiles	-4.1
Educational Services	-14.0	IT Consulting	-3.1
Health-Care Supplies	-7.8	Photographic Products	-2.1
Computer Stores	-7.3	Internet Retailers	-2.1
Wireless Services	-6.9	Auto Parts & Equipment	-1.1

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	12.2	Latin America	67.0
Japan	10.0	Natural Resources	52.8
Diversified Pacific/Asia	7.3	Precious Metals	46.1
Foreign	5.3	Diversified Emerg. Mkts.	40.2
LAGGARDS		LAGGARDS	
Communications	-0.7	Domestic Hybrid	7.3
Small-cap Blend	-0.3	Miscellaneous	8.6
Small-cap Growth	-0.2	Large-cap Blend	9.1
Small-cap Value	-0.1	Financial	9.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Precs. Mtls. Inv.	18.4	ProFunds Ultra Japan Inv.	101.3
Glenmede International	17.2	Gartmore Gl. Ntrl. Rscs. A	78.8
Fidelity Japan Small Co	16.9	Fidelity Advisor Korea A	77.9
U.S. Global Invrs. Gold	16.1	Guinness Atkn. Gl. Energy	76.8
LAGGARDS		LAGGARDS	
STI Sm. Cap Val. Eq. C	-18.6	Ameritor Investment	-65.0
Bridgeway Micro Cap Ltd.	-16.7	American Heritage Grth.	-42.9
Ameritor Investment	-12.5	American Heritage	-33.3
Guardian UBS Sm. Cap Val. A	-11.2	Frontier MicroCap	-30.8

INTEREST RATES

KEY RATES

	JAN. 4	WEEK AGO	YEAR AGO
Money Market Funds	3.83%	3.79%	1.7%
90-Day Treasury Bills	4.19	3.95	2.3
2-Year Treasury Notes	4.30	4.36	3.2
10-Year Treasury Notes	4.34	4.38	4.2
30-Year Treasury Bonds	4.54	4.53	4.8
30-Year Fixed Mortgage †	6.08	6.11	5.8

†BanksQuote.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BI
General Obligations	3.83%	4.1
Taxable Equivalent	5.47	6
Insured Revenue Bonds	3.92	4
Taxable Equivalent	5.60	6

THE WEEK AHEAD

INTERNATIONAL TRADE

Thursday, Jan. 12, 8:30 a.m. EST » The foreign trade deficit probably narrowed to \$66.3 billion for November. That's the median forecast of economists surveyed by Action Economics. A jump in imports and decline in exports led to a record trade gap of \$68.9 billion in October.

EXPORT-IMPORT PRICES

Thursday, Jan. 12, 8:30 a.m. EST » Both export and import

prices are forecast to have held steady in December. In November export prices fell 0.9%, while a decline in energy prices led to a 1.7% drop in import prices.

RETAIL SALES Friday, Jan. 13, 8:30 a.m. EST » December retail sales probably climbed 0.7%, and a smaller 0.4% when excluding vehicle sales. In November sales rose 0.3% but were down 0.3% when the rebound in autos was excluded.

PRODUCER PRICE INDEX

Friday, Jan. 13, 8:30 a.m. EST » December producer prices are expected to have increased 0.2%, following a 0.7% energy-related decline in November. Excluding food and energy, prices probably grew 0.2%, after a 0.1% rise.

BUSINESS INVENTORIES Friday, Jan. 13, 10 a.m. EST » November inventory levels most likely grew by 0.4%, after a 0.3% climb during October.

The BusinessWeek production index improved to 268.5 for the ended Dec. 24, a 13.5% rise from year ago. Before calculation of four-week moving average, the climbed to 276.9.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/e

The Companies

This index gives the starting page for a story or feature with significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Your Magic Number

THE NUMBER A Completely Different Way to Think About the Rest of Your Life

By Lee Eisenberg; Free Press; 268pp; \$26

January, 2006, marks the 60th birthday of the oldest baby boomers, the leading edge of the 76 million-strong generation born between 1946 and 1964. The group that roared at Dustin Hoffman in *The Graduate* and rocked at Woodstock is now chuckling at Diane Keaton's Mrs. Robinson-like antics in *Something's*

Gotta Give and flocking to concerts by the sexagenarian Rolling Stones. Little wonder that retirement planning has become a national obsession. The media assiduously cover the finances of an aging population: 401(k)s and IRAs. Mutual funds and long-term-care insurance.

Boomers follow the markets, page through investing books, and confer with their money advisers. Despite that, most folks who are nearing retirement—whether they occupy executive suites or cubicles—are haunted by financial uncertainty and wonder whether they have really set aside enough for life's later stages. "What are the chances that you'll live out your days in comfort?" asks Lee Eisenberg, author of *The Number: A Completely Different Way to Think About the Rest of Your Life*. "Do you have what it takes right now? What happens if you don't make it to your Number?"

Good questions all, with the last one enough to make most of us shudder. Eisenberg is the former editor-in-chief of *Esquire* and more recently executive vice-president and creative director at retailer Lands' End. He uses the device of the Number—that uncertain sum of money we'll need to live well during the golden years—to write a meditation on retirement planning as a journey and a quest. In actuality, the Number is unknowable, Eisenberg says. But in the end, he offers guidelines: For example, a middle-class person used to living on \$200,000 a year will need something north of \$2 million and south of \$5 million. Along the way we visit many of his pals and professional acquaintances, spend time at the headquarters of mutual fund giant Fidelity Investments, attend a Weyerhaeuser Co. employee-retirement seminar, and fly to Hawaii to interview a personal finance guru. *The Number* is a valuable addition to anyone's bookshelf, although aspects are disappointing: For my taste, the book feels increasingly haphazard near the end.

The author uses anecdotes to illuminate his six Eisenberg Uncertainty Principles. Boiled down, the uncertainties stem from: 1) living in a society steeped in debt with little peer pressure to get your financial house in order; 2) not knowing how money works; 3) the withering retirement system; 4) the

dark clouds hanging over pensions; 5) the difficulty of finding trustworthy guide; and 6) questions about what truly matters.

Yet this is not a typical personal finance book, thank goodness. The value of *The Number* lies in its conversation about getting older, insights about key questions for any financial blueprint, and, most crucial, ruminations on what makes for a satisfying life. Eisenberg is a good storyteller with sense of humor, the kind of guy with whom you'd like to share a drink. He has a knack for the wry aside and a real ability to distill complex information. Put it this way: *The Number* is designed to get you thinking about what you want from life, and by that metric it succeeds. "An unexamined life may or may not

be worth living—but it's almost always more costly than the examined one," he writes. Amen.

That said, don't buy the marketing slogan. *The Number* is billed as a new way to think about the rest of your life. It isn't. Throughout this book I was troubled that most of its characters were very successful. Their "number" worries seem to revolve around whether they will be able to own a third home or not. Yes, money may be irrelevant in the end, as one character says, but we should all be so lucky.

Indeed, *The Number* is really less about retirement and more about downshifting. It considers how those who have flourished, now in their late 50s and early 60s, can say goodbye to their office mates—not to hit the golf course, but to find another, more satisfying career. That's what happened to Eisenberg, a tale he relates

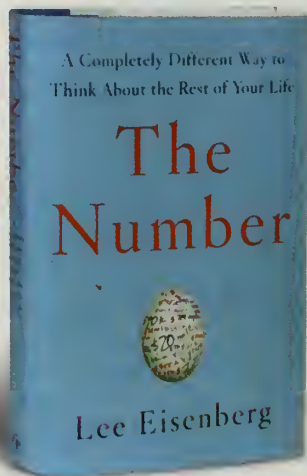
in a Woody Allen-esque manner. Highly successful Manhattan editor in his mid-50s ends up with Lands' End in Dodgeville, Wis. (population 3,022). Uprooted family, cashes in stock options when Sears, Roebuck & Co. closes Lands' End. Writes a book. Not that's not a bad model for a second or third act.

To me, it's the message of Eisenberg's own story that stands out. Yes, you have to

Retirement planning as a journey—but mostly for those traveling first class

save, but the basics of personal finance are pretty simple. Set aside some income every year. Don't take on credit-card debt. Don't put all your investment eggs in one basket. But when it comes to planning for retirement, the investments that matter are education, career, and networks—the intangibles economists call human capital. Want to examine a really good portfolio? Read the Acknowledgements at the end of the book. Opportunity knocks for anyone with friends and colleagues like that. ■

—By Christopher F.



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IdeasViewpoint

BY ROGER L. MARTIN

What Innovation Advantage?

There is a romantic notion in North American business that its future lies in design and innovation, while India and China will be the home of less skilled, lower-paying operations churning out the products and services the U.S. comes up with. It is a nifty twist on David Ricardo's seminal 19th century theory of "comparative advantage," which explained why cloudy

and cool England exported woolen goods to sunny and hot Spain, which in turn exported wine to England.

The problem is that the theory didn't ring true when I rode through the streets of Hyderabad, Bombay, and Bangalore on visits to major Indian companies. At Tata Consultancy Services' 23-acre campus in Bombay, for instance, I learned about its central goal of providing customers with not just an acceptable-quality service but also a user experience that delights and surprises. To accomplish this, its tech professionals also are taught how to manage client change.

AT ANY GIVEN TIME on Satyam Computer Services Ltd.'s 120-acre campus on the outskirts of Hyderabad, 1,000 staffers are in intensive training. Plenty of the instruction is eye-glazing, info tech jargon: "J2EE Development using JBOSS." But there's also a "Finding a Better Way" sequence that includes sessions on creative problem solving and managing innovation—hardly low-end stuff. Likewise, ICICI Bank management in Bombay is obsessively assembling talent that exhibits passion, perseverance, and bias for action rather than a willingness to perform routine tasks in front of a terminal. Meanwhile, Infosys Technologies is ramping up recruiting at the world's leading business schools.

These globally oriented outfits are not entrusting all creativity, design, and innovation to "first world" opponents while they huddle over their workstations. True, they have staggering cost advantages over traditional competitors. But that doesn't mean they are incapable of design and innovation. (Their North American rivals just wish they were.) The Ricardian logic, based on so-called natural endowments, simply doesn't apply.

This is not the first time the theory has been applied with checkered results. For decades, America's Big Three carmakers reasoned that Japanese manufacturers would stick with their "natural advantage" in small, inexpensive cars and allow them to dominate the lucrative high end. But Detroit painfully learned otherwise as Japan ultimately became a fierce competitor in almost every market segment.

More recently, companies like Solectron, Flextronics, and Celestica grew spectacularly in the 1990s by making equipment designed fully by big names such as Dell, IBM, and Nortel. But they dismissed Taiwanese manufacturers like BenQ, Hon Hai Precision Industry, and HTC, which designed and built mainly low-end gear for "no-name" PC vendors, being nothing but unskilled low-cost players. Wrong. The Taiwanese companies actually had more engineers, held more patents, and performed more research and development. And in recent years they've dominated ever-more-sophisticated segments of the industry.

Assuming that capabilities are static and advantages are permanent is a mistake. Natural endowments—climate, location, and mineral resources may be enduring, but company-generated capabilities are quite fluid. It is as much an error to assume that competitors won't attempt to develop a capability because it seemingly conflicts with an existing one—in this case low cost vs. innovation expertise. The general rule: If the opposite of a capability sounds stupid, competitors won't try to acquire it—they'll pursue the reasonable one. For example, the opposite of choosing to be "customer-oriented" is to elect to ignore your customers, a truly daft proposal.

Since lackluster design and staid conformity are obviously bad ideas, it is safe to assume that compelling design and potent innovation are going to be almost universally sought. So North American companies, many of which have pretty dreary design, are wrong if they assume their Asian rivals will pay no attention.

In the end, design is about refusing to accept apparent trade-offs and instead innovating around them to produce creative resolutions. If North American businesses genuinely want to ward off Indian and Chinese rivals, they'd better stop by rejecting the notion of an apparent trade-off between cost on one hand and design and innovation on the other.

Roger L. Martin is Dean of the Rotman School of Management at the University of Toronto and a columnist on BusinessWeek Online's Innovation & Design channel.

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Ideas Outside Shot

BY STEVEN RATTNER

Don't Fence in Hedge Funds

As a partner in an investment firm whose repertoire includes hedge funds, I'm faintly amused by the skirmishing over risk, regulation, and even the suitability of these vehicles. So much commotion over words—"hedge fund"—that by themselves denote not an investment strategy but a compensation structure.

That certainly wasn't the case in 1949 when Alfred Winslow Jones formed the first hedge fund with the then novel concept of balancing his long stock positions by selling short other stocks to protect, or hedge, against market risk. From that well-defined antecedent, "hedge funds" have become a melting pot of fee-thirsty money managers.

Today's hedge funds travel the galaxy of asset classes, from bonds to stocks to commodities to real estate and beyond. Some try to make money by exploiting small differences in security values at (theoretically, anyway) little risk. Others swing for the fences with huge directional bets and minimal, if any, hedging. Trading strategies can be similarly varied. Some managers shuffle their holdings on each new juicy fragment of information, while others practice Warren Buffett-like long-term investing. A current flavor in hedge-fund land is the "long only" fund: no shorting at all, but still hefty fees.

In fact, successful hedge funds consistently reflect only two not unrelated features: high fees and strong performance. As justification for the fees, managers often stress the skill needed to minimize risk by operating on both sides of the market. But most investors evaluate the high fees differently—by the results. Smart investors focus on picking the best managers and swallowing the fees when they think they will net out ahead. Indeed, some of the most successful hedge funds, such as Renaissance Technologies Corp. and SAC, pocket up to 50% of the profits and still deliver breathtaking net returns.

What frightens investors and regulators alike is the wide disparity of performance, prudence, and even honesty that pervades hedge funds. In the traditional asset management world, performance also varies. But these fee-based managers generally limit each fund to a single defined universe (such as U.S. large-cap stocks), constructing workmanlike portfolios that, not surprisingly, yield workmanlike results, often just tracking the market averages. Meanwhile, heavy regulation protects against fraud.

In the Wild West of hedge funds, the latitude given to managers—free to wander the investment globe looking for

opportunities, free to leverage, and mostly free of supervision has led some experts, such as Yale University investment chief David Swensen, to warn off individuals. But too much caution can be as painful as too little. The import of much publicized frauds (Bayou) and meltdowns (Wood River or Long Term Capital Management) shrinks when measured against 8,000 hedge funds shepherding \$1 trillion-plus in capital.

Most important, even averaging in poor performers, hedge funds historically have delivered, particularly in down markets. To be sure, the flood of money and people into hedge funds have made outside returns harder to come by—the typical hedge fund returned 5.9% for the first 11 months of 2005, compared with 4.9% for the Standard & Poor's 500-stock index. Those aren't the double-digit returns of yore, but it's still outperformance, and it may well continue for a simple reason: High fees (high compensation) still draw the best and the brightest to hedge funds.

Investing in hedge funds need not be an exercise in fear. With maturity has come greater visibility into overall investment approach, use of leverage, portfolio concentration, risk control and the like. The government has moved to require registration of many hedge funds (harmless, but of dubious benefit in netting out occasional bad actor). A more useful requirement would be greater standardization

of how performance and risk levels are reported. But mandatory portfolio transparency—another idea floating in the regulatory ether—would needlessly endanger performance.

Direct hedge fund investing should continue to be limited to institutions and only the wealthiest (and presumably knowledgeable) individuals. Others can invest in publicly registered "funds of funds," which provide more diversification, more disclosure, and a sophisticated intermediary to evaluate underlying funds. For investors and regulators, the secret to understanding hedge funds is to accept the irrelevance of the term "hedge fund." ■

Steven Rattner is managing principal of private investments at Quadrangle Group and former deputy chairman of Lazard.

With a wide range of investing styles, they need room to roam



BusinessWeek

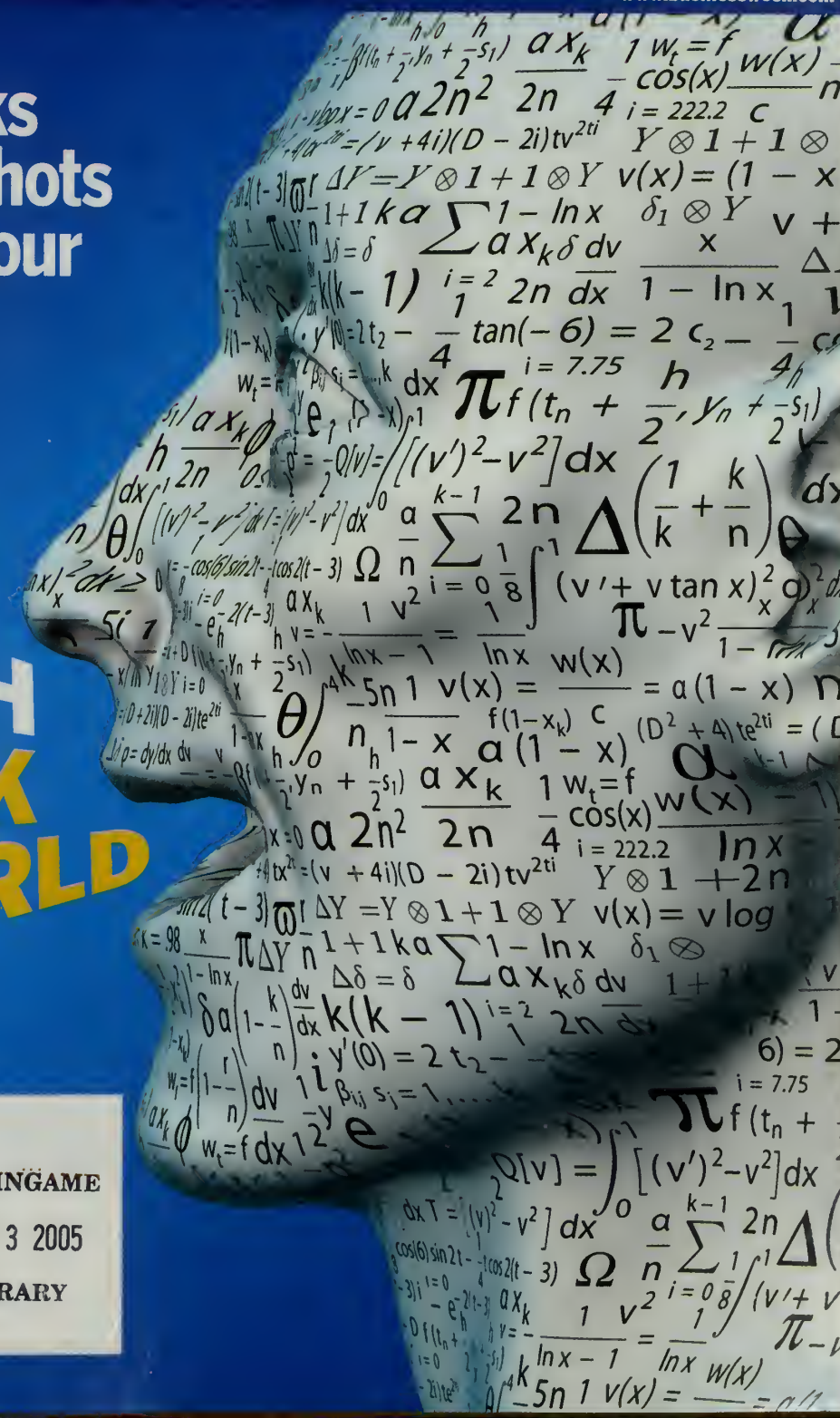
23, 2006

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More math geeks
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STEPHEN BAKER (P.54)

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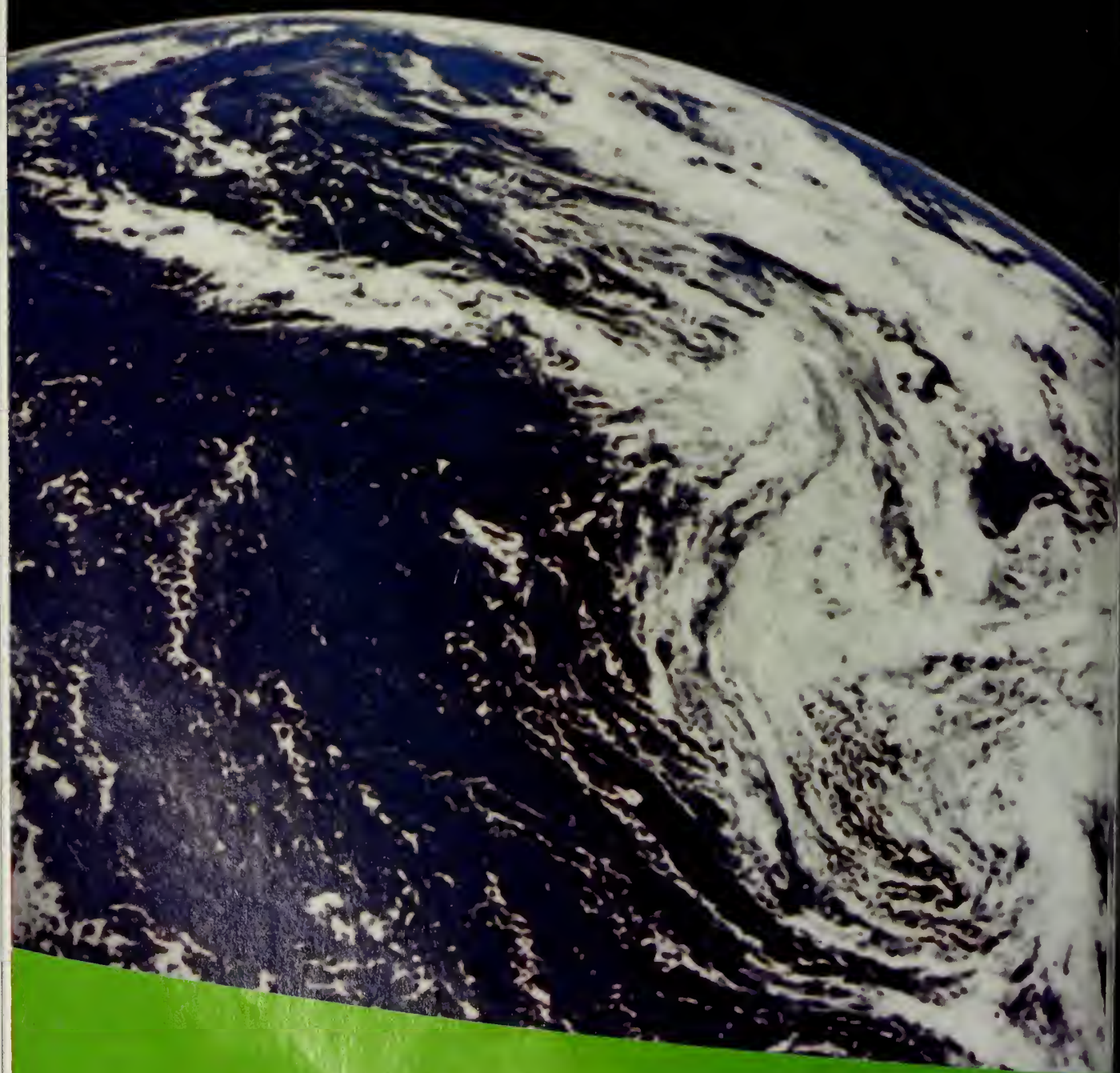
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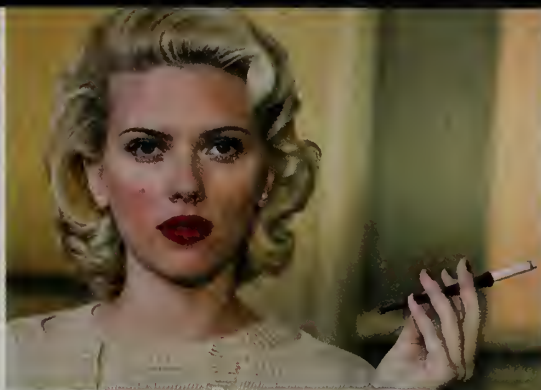
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Jobs delivers the keynote address at Macworld Expo on Jan. 10

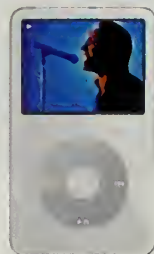
Apple at the Crossroads

What will 2006 bring for Steve Jobs & Co.? At Macworld in San Francisco, Apple's CEO said the company sold 14 million iPods in the last quarter of 2005, millions more than expected.

This **Online Special Report** takes an in-depth look at the challenges ahead for one of last year's great success stories. It explains why the switch to Intel chips may be just what Apple needs because it could finally put Macs on an equal footing with the rest of the PC world. And explores how software developers are scrambling to rewrite applications to run on the new Intel chips. **Also online:** a surprise



The new MacBook with Intel inside



iPod sales continue to rock

look at the vibrant rumor mill surrounding Apple that says it probably helps the company decide which new products are worth pursuing. And in an **exclusive online Q&A**, author and Harvard B-School professor Clayton Christensen lays out the argument for how Apple could mess up, again. **Plus:** View a **slide show** the newest accessories for iPods, from a DVR kit to scroll-wheel-friendly gloves. Find all these and more at www.businessweek.com/go/apple06

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JP Front

"Everyone who is going to miss the consensus number is going to throw out the hurricane as an excuse."

—Ben Dell, an analyst at Sanford C. Bernstein & Co., to The New York Times about fourth-quarter earnings reports

ED BY DAN BEUCKE

THE BOOK BIZ MAKING NICE MAKE SALES



COLUMN in *The New York Times*, Paul Krugman is one of President George W. Bush's most outspoken foes. In a column of a Job, Bushie," the Princeton University economist was named on Dec. 30, accusing the president of breaking the wind misleading the public. But Krugman is far more generous to the president in his introductory book, *Economics* (Worth Publishers), which came out on Dec. 22. There he praises the president's advisers for supporting "aggressive" measures to end the 2001 recession. He contrasts a confident president with a squinting

Herbert Hoover, whose policies worsened the Depression. Far from picking fights with Republican academics, Krugman writes that "media coverage tends to exaggerate the real differences in views among economists."

The homogenization of Paul Krugman may illustrate a basic principle of economics: The customer is always right. Textbooks are chosen by professors of all political stripes. Krugman says in an interview that he and his wife and co-author, Robin Wells, were "extremely careful" to be evenhanded.

So far, Krugman says, there's no evidence that buyers have been turned off by his column. Good thing. His competition includes two of Bush's former chief economic advisers: R. Glenn Hubbard of **Columbia University**, who has a new textbook, and best-selling N. Gregory Mankiw of **Harvard University**, whose fourth edition arrives in March.

—Peter Coy



IN THE FIELD The new securities are backed by the world's second-largest oil reserves

CHAOS CONTROL

Iraq's Creditors Catch a Break

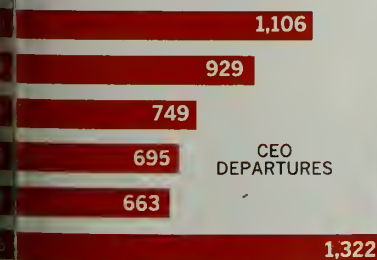
IN THE MIDST OF IRAQ'S violence, Finance Minister Ali Allawi is starting to impose order on the country's chaotic financial picture. In the latest milestone, most of Iraq's largest corporate creditors, dating to before the 1990 invasion of Kuwait, have accepted a deal to swap the bulk of Iraq's commercial debt—nearly \$14 billion—for new dollar-denominated notes. Those notes will have a face value of 20% of what companies are owed. "This will make it easier for Iraq to start getting the type of credits it needs for trade and business," says William Rhodes, senior vice-chairman of **Citigroup**, which arranged the deal along with **J.P. Morgan Chase**.

The pact gives Iraq a shot at rebuilding global financial credibility at a time when the U.S. is expected to trim its aid. The securities, with a yield of 5.8% per year, should start trading on Jan. 19. They're expected to be in demand, in part because they are backed by the world's second-largest oil reserves. Among the largest creditors signing on is South Korea's **Hyundai Engineering & Construction**, with \$1.65 billion owed. Others, sources say, include Japan's **Mitsubishi** and France's **BNP Paribas**. Companies receiving the securities are expected to sell them to emerging-market funds, hedge funds, and other players.

—Stanley Reed

THE BIG PICTURE

COM AT THE TOP The exit of Hewlett-Packard's Carly Fiorina was just the beginning as executive turnover doubled in 2005.



Source: Challenger, Gray & Christmas survey of announced CEO changes



NAME GAMES

MESSING WITH AN INDIAN ICON



INDIA'S \$17 BILLION-a-year software export industry has spent the past 15 years establishing the southern city of Bangalore as the country's version of Silicon Valley. But for some Indians, Bangalore's becoming synonymous with a tech boom didn't change the fact that its name was a vestige of British colonialism. Now the leaders of Karnataka state, home of the city of 6 million, want to change Bangalore's name to something closer to its original, pre-colonial moniker, Benda Kaal Ooru.

Their choice: Bengaluru.

That would be in keeping with a wave of nationalism sweeping the nation. Other Indian cities that have restored their earlier names include Bombay, which switched back to Mumbai, and Madras, to Chennai. But some in the booming software industry say changing Bangalore would be counterproductive.

"Bangalore is so much part of the global lexicon now. It has even become a verb," says Nandan Nilekani, CEO of **Infosys Technologies**, one of India's leading tech outfits. Western companies are said to be "Bangalored" when they lose out to lower-cost Indian competitors.

The name change isn't a done deal. Before it can take effect in November, 2006, it must be approved by federal officials. Also, the local government might be voted out of office—in a sense, Bangalored. —Steve Hamm



TEXT MESSAGE NATION

FOR A GLIMPSE into the future of text messaging, look at South Korea. This month the government started a program to deliver via cell phone progress reports on legal proceedings and notices of fines for traffic and environmental violations. It could go nationwide, says Jun Dae Jin at the Supreme Prosecutors' Office. The goal: to shave \$1.2 million from the government's \$2.3 million yearly bill for postage on such notices. Texting already is ubiquitous among Koreans—nearly 80% use cell phones. Banks confirm financial transactions via text, doctors and dentists use it to confirm appointments, and in 2004 credit card issuer KEB Credit Service even delivered layoff notices to 161 employees. —Jessi Hempel

BLOGSPOTTING

UNDERCOVER ON THE STREET

underthecounter.net

» **WHY READ IT:** To get the dirt on Wall Street personalities. An anonymous author posts inside dope from tipsters and links to the Web's dishiest finance news. Written with humor, irreverence, and sometimes raunch. (Note: Not for the easily offended.)

» **NOTABLE POST:** Using e-mail tips, the blog announced when investment banks would disclose 2005 yearend bonuses. On Bear Stearns: "The word is that first-year associates took home \$250,000 to \$300,000, while first-year vice-presidents banked between \$400,000 and \$500,000."

DRAWN & QUARTERED



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TAXING MATTERS



SLIPPING A GIFT TO THE WELL-HEELED

This promises to be the year Washington goes to war over **tax cuts for the rich**. Much attention will fall on the fate of high-profile levies on capital gains, dividends, and the dreaded alternative minimum tax. But keep an eye on an obscure change that will let high earners reclaim some personal exemptions and itemized deductions.

Back in 1990, those exemptions and deductions were curbed by President George H. W. Bush and Congress, effectively raising taxes for many upper-middle-class families. In 2001, the current President Bush and Congress quietly agreed to dump the limits. One reason for the lack of fanfare: The cuts largely benefit those making \$150,000 a year or more, eventually delivering more than \$19,000 a year for those making over \$1 million. Also, by decade's end the change is expected to boost the deficit by \$10 billion a year. Congress delayed the changes until 2006 and will phase them in over five years.

Now that the tax breaks are about to resume, Democrats are sure to make a fuss. But expect GOP votes to prevail. —Howard Gleckman

COLD COMFORT

YOU TRY TO TYPE WEARING MITTENS

SKYROCKETING COSTS have many corporations scrambling to turn down thermostats, and a few are even installing solar panels. But as energy misers, companies can't hold a candle to educators. **Pittsburgh Public Schools** is considering charging employees \$25 to \$50 annually for every space heater or coffee pot they plug in. The idea emerged from the district's energy labor-management committee, which was formed in September and charged with finding ways to cut costs. Meanwhile, staff at Minnesota's **Saint Paul Public Schools** received letters in November asking employees to voluntarily pay a \$25 "reimbursement fee" for the energy consumed by their personal appliances.

Over the Christmas holiday, **North Carolina State University**



housekeeper Evelyn Hill had to resort to wearing three shirts and a pair of gloves to clean campus buildings. The temperature had been lowered to about 55F in a cost-saving move. Most professors and students were gone, but administrators and facilities staff were left to toil in the cold. "They think it's O.K. to affect our livelihood to save a few bucks; I find something wrong with that," says

Hill. Despite a petition signed by 150 people, the school stuck with its plan; administrators say their natural bill rose 55% last year.

The belt-tightening may have other costs, though 2004 productivity study. **Cornell University** found that when office temperature were lowered nine degrees to 68F, typing errors rose 74%, and output dropped 46%. —Megan T

CATCH 'EM WHERE YOU CAN

AS GROWING NUMBERS of people skip TV and radio commercials, ads continue migrating to unexpected places:



SUBWAY TURNSTILES Monster Media and Viacom Outdoor have dressed nearly 400 turnstiles in Chicago's transit system with their "AdSleeves" for Geico.

PARKING LOT STRIPES Greg Gorman's new venture, Parking Stripe, makes vinyl ads to install over parking lot lines. Home Depot and others have signed on.

WATER COOLERS CBS has used AquaCell water-cooler "billboards" to promote shows such as *Out of Practice* and *Courting Alex*.

AIRPLANE TRAY TABLES Scandinavian Airlines rents out the backs of its aircraft tray tables in business and economy sections.

GAS PUMPS Dresser Wayne's Ovation iX gas pump broadcasts video commercials on a built-in screen and offers printable coupons.

Data: BusinessWeek



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The fact that our currency did not collapse in the year just past does not invalidate my view that it eventually must."

—Peter D. Schiff
 Darien, Conn.



FOLLOWING UP ON INVESTMENT PICKS

IT IS ALWAYS INTERESTING to read your ideas in "Where to Invest" (Cover Story, Dec. 26/Jan. 2) on what may be a good investment in a forthcoming year. However, it would be interesting and enlightening for both forecasters and readers if you published a scorecard on what happened to your picks of the prior year. I lost a good bit of money by taking your 2005 recommendation that Doral Financial Corp. was a good [banking] company to invest in ("How to seize a gran oportunidad," Where to Invest, Cover Story, Dec. 27, 2004). I don't expect you to make up my loss, but some sympathy would be nice.

—Matthew Schein
 Jerusalem

"AFTER THE HOUSING runup" (Smart Strategies, "Where to invest," Dec. 26/Jan. 2) misses the mark on a couple of points regarding office real estate investment trusts. The statement "REITs that own hotels or apartments might be good choices because they can raise their rents...as opposed to, say, office building owners, whose tenants are protected by long lease-

es" would seem to imply that rents are changing over the life of a lease. In real annual rent increases are typically built into most long-term leases. Such leases fully protect the investor.

The statement "stay away from REITs that own office buildings...the value of their buildings tends to fall when interest rates rise" would be true for a REIT with only one building and no provision for rent increases. But REITs are portfolio properties, and a smart portfolio manager will diversify lease expirations over many years. In any given year, leases for renegotiation will almost always include rent increases in periods of rising interest rates caused by inflation and strong economic growth.

Your math is accurate. But other components of the equation are not fixed, which means, if the REIT does its job, operating income will rise.

—Leo Welton
 Norcross, Ga.

HIS TIMING WAS OFF, BUT HE STANDS BY HIS PREDICTION

AS A RESULT of my Jan. 2, 2005, assertion that 2005 "could" be the year that the dollar finally collapsed, *BusinessWeek*

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PRINTED IN T

ed the dubious honor of making it ninth of "The 10 Worst Economic Predictions About 2005" (Up Front, Dec. 2). Although I was not alone in predicting dollar weakness, the fact that the dollar did not collapse in the year past does not invalidate my view that it eventually must. There is simply no other way that will rectify the world's gaping economic imbalances. Whenever the dollar finally stops for the greenback, be it in 2005 or 2007, the economic fallout will only be the big story of the year. Although my dollar call may have been premature, I'm also on record for predicting that 2005 would see oil rising to \$65 per barrel, and gold break through \$500 per ounce. I can only assume that the magazine is planning to use those predictions for a similar article on the year's most accurate predictions.

—Peter D. Schiff
President

Euro Pacific Capital Inc.
Darien, Conn.

CHECKUP ON ORGAN DONOR OPTIONS

CATHERINE ARNST CALLS LifeSharers, which rewards registered organ donors with preferred access to transplantable organs, a "closed network" ("Check a box to save a life," Viewpoint, Dec. 26/Jan. 2). The exact opposite is true. Membership is free and open to all (lifesharers.org/388-ORGAN88). We welcome everyone and we turn no one away.

About 70% of the organs transplanted in the U.S. go to people who haven't agreed to donate their own organs when they die. LifeSharers makes the organ allocation system fairer by helping registered organ donors get a fair shake.

—David J. Undis
Executive Director
LifeSharers
Nashville

A MAJORITY of adults with alpha-1 antitrypsin deficiency get genetically induced emphysema, in addition to other chronic obstructive pulmonary diseases. (I know this because I have alpha-1, too.) I belong to an alpha-1 education group, and most of the people in the group are in desperate need of a lung transplant, just as my friend is in desperate need of a liver transplant. The Alpha-1 Foundation (<http://www.alphaone.org>) is a wonderful resource. Its president, John W. Walsh, is an alpha-1, too (as we call ourselves).

Alpha-1 is still regarded by many doctors as a textbook illness, and they don't understand it. There are about 5,000 known

CORRECTIONS & CLARIFICATIONS

The photo accompanying "Venture capital's new Promised Land" (Global Business, Jan. 16) was incorrectly captioned. It depicts Marc Verissimo, chief strategy officer of SVB Financial Group (left) and Hua Yuda, chairman of Shanghai Venture Capital (not Daniel Quon, senior vice-president, SVB Global), at the opening of SVB's Shanghai office.

"Curling up with a good e-book" (News: Analysis & Commentary, Jan. 9) misstated the total number of books sold by U.S. publishers worldwide in 2004. The correct figure is 2.3 billion; e-books account for just under 0.1% of that number.

In the Yearend Quiz (Up Front, Jan. 9), question No. 5 should have asked what Internet company launched a search for a new chef, not chief. The answer was Google.

In "The sage of Kansas City" ("Where to Invest," Cover Story, Dec. 26), the winning forecast was less than 0.1% lower, not higher, than the NASDAQ Composite.

alphas in the U.S., but it is estimated that 80,000 to 100,000 people in the U.S. have it. It's not curable, but there is therapy for it (a weekly IV infusion) and other things we alphas can do to help ourselves be functional and live longer. For my alpha friends and all alphas who desperately need lung and liver transplants, I thank you so much for writing about this.

—Liz Johnson
Winchester, Mass.

Editor's note: Rob Fasano successfully received a liver transplant on Dec. 19.

CATHERINE ARNST is right on. Medical professionals and families would not face such heart-wrenching decisions if organ donation were mandatory. Our culture is more than ready to define itself a "giving" society. Nothing stands in the way of this gift, except the health of the donor. It should be something on which we can build a consensus. Unfortunately, programs making everyone a donor (with a provisional choice to opt out) seem not to be a priority to lawmakers. It certainly would be a statement for the ages if we all made the choice to opt in.

—Dale Gilbert
Boca Raton, Fla.

LET'S HEAR IT FOR JAPAN'S SUPERCRAFTSMEN

HOW WONDERFUL to read about Japan's *supaa ginosha*—those special technicians

who are drawn to the details ("Better than robots," Global Business, Dec. 26/Jan. 2). Having lived in Japan for seven years, I assure you that these supertalented craftspeople work everywhere in the country—from factories to business offices. And while it can be frustrating to sometimes face an impending deadline in a business setting when you're working with someone who's overly focused on the details, it's very heartening to see that in factories where these skills are required to give Japan a competitive edge, the talent is being recognized.

—Nikki Martin
Long Beach, Calif.

EDUCATION IS THE BEST WAY TO SOLVE AFRICA'S PROBLEMS

GUY PFEFFERMANN'S "Give Africa's B-schools a boost" (Outside Shot, Dec. 26/Jan. 2) points out a very pressing problem when it comes to arming Africa with the tools and knowledge to fight poverty and disease, and to rebuild the infrastructure of countries torn apart by war and corruption. Simply throwing foreign aid at the problem may assuage Western guilt, but really provides little long-term benefit. Instead, we must insist Africa invest in its own citizens, rather than seek debt forgiveness and Western currency.

The African continent is amazing and diverse, as are its people. This asset is all too often overlooked as a method of relieving some of the problems plaguing most of Africa's nations. Education of Africans, by Africans, can begin to erase some of the inequality that leads to corruption and military juntas. But if educated Africans simply leave the continent for more promising futures abroad, this can never be realized.

—Martin Schneider
New York

How to reach BusinessWeek

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Microsoft's Right Brain

LIKE MOST GOOD GEEKS, Rick Rashid is a hard-core *Star Trek* nut. He's got the *Star Trek* symbol on his office door, and little figures from the show line his shelves. He was even friends with the late actor James Doohan, who played Scotty. How does all that relate to his life as a top researcher at Microsoft Corp.? "It's all

about possibilities," he says. "The reason I went into computer science is that I wanted to create something that hadn't been done before."

As professor in this field at Carnegie Mellon University in the 1980s, Rashid was lead developer of a computer operating system that moved data more efficiently than other programs. The OS, called Mach, was freely released to developers to use as they wish, and the core of the technology is still active inside Apple Computer Inc.'s OS X software for the Mac, among other places.

Microsoft hired Rashid, 54, from Carnegie Mellon in 1991, and he now runs one of the most ambitious basic-research units in the business. As senior vice president of research, Rashid manages more than 600 research scientists scattered among labs in Bangalore; Beijing; Cambridge, England; San Francisco; Silicon Valley; and Redmond, Wash. Despite the sprawl, Rashid tries to model this operation on a university lab—though most academics, however, would probably envy the \$250 million a year that Rashid has to throw at projects on the frontiers of information technology.

Rashid's work makes up a tiny piece of Microsoft's overall \$6.2 billion research and development operation, but it's one of the most important parts. Mere incremental improvements

to Microsoft products aren't the charter of Rashid's group. Instead, he pushes his staff to go after the big challenges: imbuing machines with the ability to understand language exactly as it is spoken, ironing the inefficiencies out of computer networks, generating sharp computer graphics; viewer might mistake for reality—and yes, tackling the next industry-altering leap in operating systems. "There isn't a constraint," Rashid says. "Research has no schedule."

All of this requires changing the traditional metrics behind corporate research. Rather than measuring researchers' performance based on the amount of work that gets transferred into the company's products, staff members are judged on a

number of important papers they unveil in technical journals or at conferences. His unit is a magnet for talented PhD scientists. Several Microsoft researchers, including Rashid, are members of the National Academy of Engineering, something of a geek hall of fame. Many on the team are "people who want to change the world," he says. "They have an evangelical zeal."

As with all basic research projects carry a high risk of failure, so staff members don't assume they'll see their hard work built into products. Still, the chance to put an invention in the hands

of Microsoft's hundreds of millions of users is a heady incentive, and it's striking how often Rashid's team pulls it off.

Responding to critics who carp that Microsoft just copies others' best work, Rashid can reel off dozens of strides his team has made—like the grammar checker in Microsoft Office, and ClearType, a display technology that produces crisper text resolution in Windows XP. Researchers also came up with spam filters that block unwanted e-mails in MSN Hotmail, a free feature that stops 3.2 billion messages a day. The steady anti-Microsoft harping is "one of those things where people don't think it through," Rashid says.

Rashid's own innovations didn't end with Mach. Among other things, he has developed video games. His first title was *Alto Trek*, a sci-fi romp released three decades ago. In 2000 Microsoft's games division came out with a sequel, *Allegiance*. Games are a definitely a gas, Rashid says. But it's the science that lets him boldly go where no one has gone before. ■

—By Jay C.



Rashid pushes his research scientists to go after the really big challenges

A woman with dark hair, wearing a black off-the-shoulder dress and black heels, is walking on a city sidewalk. She is carrying a black shoulder bag and two shopping bags, one red and one black. To her right is a store window with a large glass pane and a red pillar. The window displays various items, including a mannequin and some plants. The background shows a city street with trees and buildings.

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Shoes have a shoe box. Suits have a garment bag. Even eggs have a carton to protect them. And most important,

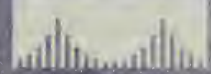
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Technology&You

BY STEPHEN H. WILDSTROM

Analog TV: Fade to Black

On Feb. 17, 2009, television sets based on technology used for the past 60 years will cease to work. As one of its first acts this year, Congress will decree that broadcasters must end analog transmissions on that date and switch to the digital technology they have been phasing in for several years. While it sounds dramatic, most Americans won't notice the change

Television's digital transition has been the source of angst and debate in government and in the entertainment and consumer-electronics industries for more than a decade. In 1996, Congress gave broadcasters spectrum to begin digital broadcasts on the condition that their original frequencies would revert to the government at the end of this year. No one really took that date seriously, but the new deadline, part of a massive budget bill awaiting final passage when lawmakers return from break, looks firm.

This is a very big deal for station owners, but truth is, the overwhelming majority of U.S. households—around three-quarters of them—get TV signals by cable or satellite. So most consumers will see little effect from the shift and don't need to think about it unless they happen to be buying a TV set in the next three years. All satellite and most cable signals already are digital, and set-top boxes for these systems can send the signals to either digital or analog TVs. The end of analog will affect those who don't get cable or satellite, as well as viewers with secondary sets that aren't connected to a cable or satellite feed (for example, two of the four sets in my home rely on over-the-air because I haven't bothered running cable to them).

CONGRESS FEELS THE PAIN of voters whose analog-only sets will be rendered obsolete by the transition. The driving force behind the legislation is lawmakers' desire to raise an estimated \$10 billion by auctioning off the analog spectrum. Of that, \$1.5 billion will go to subsidize consumers' purchases of converters, expected to cost about \$60, that will let old sets receive the digital broadcasts. A bigger burden awaits consumers who want to buy a new set during the transition. Under Federal Communication Commission rules, all TVs bigger than 36 inches must include a digital tuner that can handle the new broadcasts. Manufacturers can get around this with some sets by calling them "displays" and not including any sort of tuner; these are fine for cable or satellite reception. Half of all sets between 25 in. and 36 in. must also have digital tuners. That requirement goes to 100% on Mar. 1



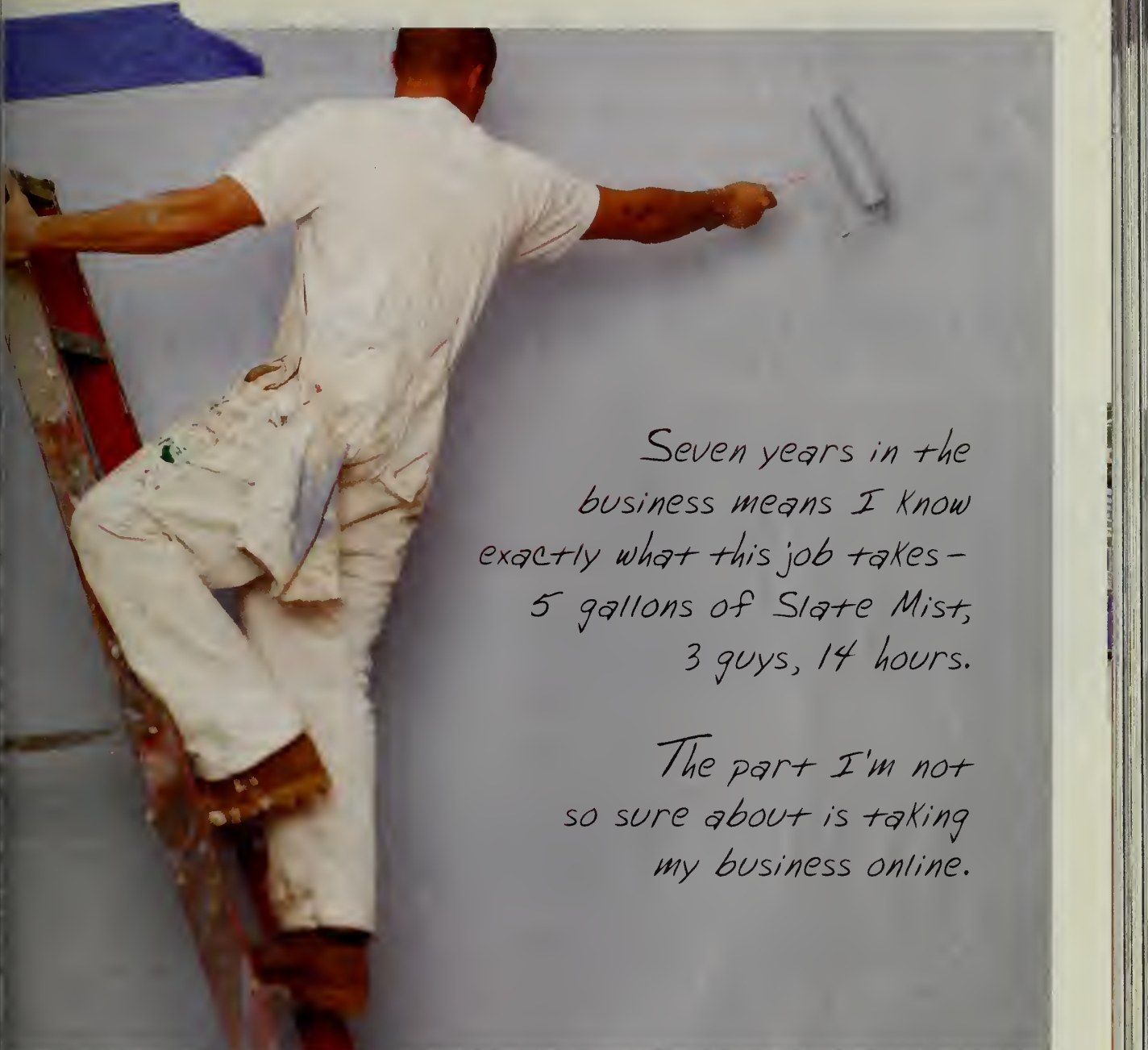
Planning to buy a TV set anytime soon? Make sure it's digital-ready

relatively inexpensive set in the next year or so, perhaps to receive over-the-air broadcasts in the kitchen or a bedroom, you should plan either on buying an adapter or buying a digital version when the size you want is available.

In the long run, the digital transition will be good for consumers, mainly because as all programming becomes digital, more and more of it will be high-definition, too. In meantime, shopping for televisions may be a bit confusing.

E-mail: techandyou@businessweek.com

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Putting the Screws to Google

What if 2006 is the year big media players take aim at Google's kneecaps? No, not with more lawsuits; the Authors Guild, the Association of American Publishers—on behalf, in part, of *BusinessWeek*'s parent company, The McGraw-Hill Companies—and Agence France-Presse have already sued the search behemoth. Rather, picture this: Walt Disney, New

Corp., NBC Universal, and *The New York Times*, in an odd tableau of unity, join together and say: "We are the founding members of the Content Consortium. Next month we launch our free, searchable Web site, which no outside search engines can access." (A simple bit of code is all it takes to bar all or some major search engines from accessing a site.) "From now on we'll make our stuff available and sell ads around it and the searches for it, but only on our terms. Who else wants to join us? Membership's free."

A Content Consortium would wreak havoc with the Web as we know it in its bid to restore the role of content owner as gatekeeper. It could shrink some opportunities for lucrative targeted search ads à la Google's AdWords or Yahoo! Search Marketing, applications that seriously rankle more than a few media executives. (You're selling ads against free access to my content?) Aggregating many powerful brands—*The Simpsons*, ESPN, *Law & Order*, and *The New York Times*, for starters—under one rubric would give them the heft that no individual editorial entity possesses in the search-engine economy. (For help in assembling what you may think is an unspeakably Old Media idea, I thank newspaperman-turned-wireless-executive Art Howe and Slate.com's editor-at-large, Jack Shafer.)

"FOR THE LIFE OF ME, I CAN'T IMAGINE why they haven't done it," says Tom Curley, CEO of Associated Press. Here's one reason: Doing it would require spinal implants for intimidated media barons. But the notion that some pushback is pending is not far-fetched. Curley says he is talking with potential partners about setting up subject-specific Web packages—say, for travel or basketball—that will include content from multiple media. Once partners are on board and packages are finalized, search engines will be invited to bid for that traffic.

One ethos governing Web content holds that content owners must be respected and paid. Call this the traditionalist view. Another contends that future value lies not in content but in the conversations and communities formed around it.



Call this the Web commons view. Its adherents say pulling back from today's Web has hideous implications. "The ecol produced by [a Content Consortium's] s rules is a poorer environment than what produced by the leaky, relaxed set of practices" of today, says Stanford Law School professor Lawrence Lessig. A Content Consortiumed Net, he says, would resemble one of 10 years ago, dominated proprietary services such as Prodigy. (Sh of hands: Anyone hot to go back to that? And would it work? Much of Google's ju comes from searches for product data; a

How Old Media could take back its share of search's ad bounty

selling point for AdWords is s catching consumers while they're avid to buy. Would ne or entertainment drive the r for search ads as high?

A content consortium has failed before. In 1995 nine newspaper companies joine create something similar: th New Century Network, whic failed spectacularly amid internal dissension. But 199 was long before the Web wa anything, back when Micro

wore the black hat and Yahoo posted directories of links, 1 billion-dollar earnings. Facing the gallows, the saying go concentrates the mind, and traditional media today are grappling with slowed growth—or worse. "I'm trying to t of someone who isn't under siege," says Howe.

Any such moves would bring serious side effects. Walli off search engines could reduce the Consortium's traffic t trickle and anger the open-Web crowd. But perhaps traditional players are too busy enjoying a delicious frisso worry—imagining that even though Old Media's fortune waning, it can still put some hurt on the new guys. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia



The Barker Portfolio

BY ROBERT BARKER

Too High a Price for Black Ink

that copier paper. All those yellow folders, file folders, pencils, and pens (72 Fray-brand retractable ballpoints now on sale at Office Depot for just \$14.99). The desk chairs, cell phones, laptops. Printer ink cartridges priced like caviar. How much can the value of retailing this stuff of daily commerce change in a year?

If you believe the stock market, a lot. Back in October, 2004, when this column last examined Office Depot, the stock looked like a way undervalued. Back then, it was changing hands near 14 a share. Today, with the shares above 31, I have a question: In a mere 15 months, are Office Depot's prospects really 120% better? Doubtful.

Maybe not because Office Depot is headed for a wreck. On the contrary, the company remains financially strong—it has more in cash and short-term investments than it owes in debt—and its operations are being intelligently streamlined. For example, two domestic catalog units that it had run separately, one under the Viking brand, are being consolidated into a single Office Depot-branded offering. This is another common-sense efficiency at its retail outlets are the work of Steve Odland. He joined as chief executive last March following four successful years leading car parts retailer AutoZone. I didn't reach Odland, but his chief financial officer, Patricia McKay, told me they're pleased by the stock's gains. She added, "We've got the growth priorities to drive [further] improvement in shareholder value."

AT THE SAME, it looks as if the stock market already has discounted much of what Odland, McKay & Co. might do in the foreseeable future. On Feb. 22 the Delray Beach (Fla.) company is set to unveil full-year 2005 results. Wall Street's consensus guess is for revenues of nearly \$14.2 billion and earnings per share of \$1.36, a sizable leap from \$1.06 in the previous year. In 2006 analysts are forecasting profits of \$1.56 a share, a further gain of almost 15%.

Where would that come from? Some from higher profits on their shares, since Office Depot remains an aggressive purchaser of its stock. More could come from cutting costs by reorganizing operations, particularly in Europe, to expand its margins. McKay noted that the aggressive selling by the phone, more private labeling



OFFICE DEPOT The stock is up 120% in 15 months

of such higher-margin goods as furniture and paper shredders, plus the opening of 100 new stores this year, are all set to boost sales growth and widen margins.

How fast might sales grow over the next few years? How much might margins widen? On those key issues for investors, McKay is vague.

Assume, however, that Office Depot stays on a roll and that growth in earnings keeps moving at a good clip. It's still far from clear that Office Depot is the best buy in this end of the market. According to Capital IQ, a unit of Standard & Poor's, Office Depot's operating profit margin came to 3.8% over the last twelve months. Staples' was 8%. Through last year's first nine months, the average Office Depot store in North America produced about \$198,000 in operating profit, vs. \$354,000 or so at the average Staples. McKay told me "there's nothing structurally different" between the rivals that would bar Office Depot from enjoying margins like Staples'. That will mean cutting costs further, expanding revenues, and improving its mix of merchandise to include more high-margin items. Yet today an investor pays a higher multiple for Office Depot's earnings than for Staples' (table).

Michael Souers is an S&P equity analyst who thinks Office Depot is on the right track, and is impressed by Odland's record. Yet when he considers the office-supply industry's growth rate of perhaps 3% a year and sees Office Depot trading at 20 times estimated earnings, he balks. "I just think the shares have gotten ahead of themselves," he told me, suggesting they're worth something closer to 26. Almost makes computer printer ink look like a bargain. ■

E-mail: rb@businessweek.com

WHY PAY MORE?

COMPANY (SYMBOL)	PRICE	EV/EBIT*	P/E RATIO**	LONG-TERM EARNINGS GROWTH***
Office Depot (ODP)	\$31.42	17.5	20.3	14.1%
Staples (SPLS)	22.58	12.5	18.0	15.8

*Enterprise value/trailing earnings before interest and taxes **Estimated earnings in current year
***Consensus analysts' estimate, annual rate Data: Capital IQ, Reuters PLC Estimates

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JAMES C. COOPER

One Big Reason to Expect A Decent Year for Jobs

Companies can no longer meet demand with existing forces

U.S. ECONOMY The Labor Dept.'s monthly employment report contains perhaps the government's most politically sensitive data, especially in an election year. Take the December jobs numbers. The Bush Administration and other Republicans are playing up the good news in the 4.9% jobless rate. Democrats are pouncing on the much-

less-than-expected 108,000 rise in payrolls. By the politicians and media folk run it all through the spin, it's hard to know what to think.

For the market economists, they may not always be, but the discipline of the market and their clients to keep them objective. Right now the consensus of analysts is that employment in 2006 will grow at a similar to 2005's 168,000 jobs per month; hourly wages are likely to grow a bit faster than last year's 3.1% pace; and the unemployment rate will stay close to where it is or creep a bit lower.

But there's an old saying in economic forecasting: The consensus is always wrong. So are the labor markets likely to be stronger or weaker this year than generally expected? The question is central to the outlook on consumer spending, where higher interest rates and a rash from housing-related strength are expected to be buying. The issue is also crucial to Federal Reserve policy, since the Fed has implied it will use the job markets as an indicator of potential inflation pressure.

IT BE TOO QUICK TO DISMISS the idea that the job markets could end up stronger than expected. The most important reason is one not broadly recognized: The very growth rates in payrolls and in business investment for new plants and equipment are highly related (chart). And 2006 is shaping up to be a very good year for capital spending, given exceptionally strong corporate finances and the growing incentives to expand. A quick analysis shows that, from 1990 to 2005, yearly increases in business outlays for new buildings and machines explain, on average, about 85% of the yearly growth in private-sector payrolls. For example, while all the fourth-quarter data on capital spending are not yet available, business outlays in 2005 appear to have risen by 8%, while private-sector payrolls increased by a bit less than 8 million workers. That's not far from the job growth predicted by the historical relationship.

That growth in business outlays accelerates into the 9% to 10% zone this year, which is in the range of expectations. The back-of-the-envelope model implies private payrolls will grow by 2.4 million to 2.7 million. That translates to 100,000 jobs per month or more, a clip that would

push the jobless rate into the 4% to 4.5% range by yearend and imply further upward pressure on wages. The forecasting accuracy based on this relationship isn't perfect, but what's important is that the results clearly show how sensitive job growth is to corporate spending.

The upbeat outlooks for both jobs and capital spending are partly related to the unprecedented caution busi-

nesses have shown in their spending plans, especially in the early stages of the post-recession period. As a result, business investment remains historically low in relation to gross domestic product among big nonfinancial corporations. But recent data and corporate surveys suggest that the need for

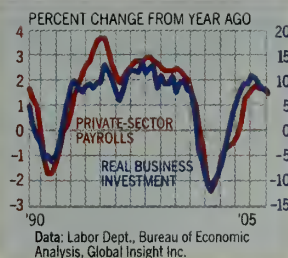
more production capacity in relation to demand is finally forcing businesses to shed some of their caution.

THAT INCLUDES WARINESS ON HIRING. A study by researchers at the Bureau of Labor Statistics, published in the December *Monthly Labor Review*, examined the hiring behavior of large "multi-establishment" corporations, which operate in more than one location in the U.S., vs. that of small "single-establishment" companies doing business in only one location.

The results show that large companies have been especially reluctant to add to their payrolls. During the downturn in jobs following the recession, the larger corporations, which comprise 57% of total employment, accounted for all of the job losses, while the smaller ones, which make up the other 43%, showed modest gains. Moreover, during the first stage of the employment upturn, beginning in 2003, the large multi-establishment outfits continued to shed jobs even as overall payrolls were turning upward.

The research doesn't offer reasons for the trend. Outsourcing may be part of the answer, but studies have

JOB GROWTH FOLLOWS CAPITAL SPENDING



been unable to explain losses of the size involved. The long-term upshift in productivity growth has not been great enough to explain all of the losses, either.

The other explanation is that many large corporations, stunned by an unprecedented array of uncertainties from corporate scandals to war to energy costs—on top of shareholders' growing demands for profits—simply have been too hesitant to make big commitments to their capital budgets and payrolls. They have tried to satisfy demand with their existing facilities and workers.

NOW THAT'S CHANGING. Based on recent sanguine surveys of corporate sentiment and last year's solid hiring trends, businesses have taken their short-term gains in productivity about as far as they can go. From here on, companies appear ready to rely increasingly on additional workers for their production growth.

Growth in total nonfarm payrolls last year most likely would have exceeded the 183,000 average in 2004 were it not for the severely depressed readings in August and September because of the hurricanes. And signs at the end of last year were encouraging for early 2006.

Although the 108,000 rise in December payrolls was far below expectations, the November job gain turned out to be 305,000 after more complete data, the largest increase in more than a year and a half. While the November jump reflects a rebound from the storms, the December gain appears to have been held back by another bout with harsh weather.

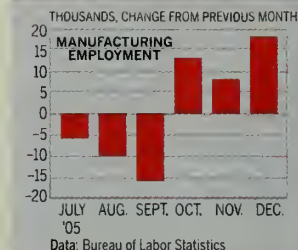
Labor reported that the number of persons not at work

due to bad weather was sharply higher in December compared with past Decembers. Supporting that notion, payrolls in the weather-influenced construction industry, which scored job gains averaging 25,000 per month from September through November, suddenly sank by 9,000 workers last month. Still, overall job gains averaged a

over 200,000 in the first two months, about the same pace as in the two months before the hurricanes. Payrolls in manufacturing, where reluctance to hire has been high, rose for the third month in a row (chart).

Other data also indicate hiring strength. Weekly jobless claims through December remained at a low level

THE UPTURN IN FACTORY PAYROLLS



consistent with monthly job gains of greater than 200,000. And the December employment index from the purchasing managers' survey of the nonmanufacturing sector, which employs about 90% of all workers, rose to the highest level since August.

The upshot of all this is that consumer spending may hold up surprisingly well in the coming year. But the financial markets' current optimistic view on interest rates might shift to one of disappointment. ■

—With James Mehring in New York

WAGES

A Misleading Predictor of Inflation

ECONOMISTS AND investors will be paying close attention to the Labor Dept.'s fourth-quarter Employment Cost Index, due out Jan. 31. So far the numbers show that wage growth is slowing, an indication of no wage-driven inflationary pressures. However, those data may be giving the markets and the Federal Reserve a false sense of security.

Through the third quarter, the ECI for private-sector wages and salaries grew by 2.2% from a year ago, down from a 3% pace two years ago. But at the same time, Labor's measure of average hourly earnings grew 3% in the fourth quarter, up from 2% two years ago. Which measure is right?

The two gauges

differ in coverage and calculation. Economists usually put more stock in the ECI, since it excludes nonproduction-related bonuses and overtime pay. Moreover, the ECI attaches a fixed weight to each occupation in order to avoid distortions due to shifting job trends across industries. That factor might be pushing up the average hourly pay measure, since the hurricanes

temporarily took many low-paying service jobs out of the mix.

Perhaps more important, though, the current weights for the ECI are based on a list of jobs from 1990. "Many of today's fastest-growing occupations did not exist in 1990," points out Morgan

Stanley chief U.S. economist Rich Berner in a Jan. 6 research note. That means many technology, science, and service jobs are not represented.

Labor plans to update its job list and weights for the ECI this March. But for now the index may be understating wage growth. The December jobs report showed wage gains were highest—up 4.6% over year—in the information industries, which include Internet jobs. Plus the ECI format may also be missing the economy's structural shift toward service-sector industries such as health care and financial services, where hourly pay is rising faster than the overall average and where job rates are far below the national level.

The truth of wage growth is most likely between the two measures. Right now the average hourly pay appears to be the more accurate gauge of how tight the labor markets are.

—By James Mehring in New York

ARE WAGES GROWING FASTER OR SLOWER?



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The Business Week

News you need to know

EDITED BY HARRY MAURER

Big Blue's Big Switch Just in time for boomers to start heading for the rocking chair, old-style retirement took another grievous blow. On Jan. 5, IBM said that in 2008 it will close its guaranteed pension plan for its 117,000 U.S. employees (CEO Sam Palmisano, photo). Since last year new staff had only been offered 401(k)s. Now veterans will have their defined-benefit pensions frozen and will be escorted into an enhanced 401(k). Current retirees will continue to collect.

The company cited competitive issues (rivals don't have these costly relics) and employee desires (no one was joining Big Blue for the pension, it says), but the pressing reason is cost. While IBM is highly profitable, its pension plans have a \$7 billion shortfall. Employee groups attacked the move, concerned that many companies would join the parade led by such outfits as Hewlett-Packard and Verizon. Investors bid up the stock 3% the next day.

See "The rush to shut down pensions," www.businessweek.com/go/tbw



Detroit Drama The biggest news at the Detroit Auto Show, which opened on Jan. 8, wasn't sleek cars but clunky car-makers. GM cut prices on many models, hoping a little realism would end the boom-and-bust incentive cycles. On Jan. 10, Jerome York, a turnaround artist and top deputy of GM shareholder Kirk Kerkorian, made a speech urging the company to ditch some brands, chop the dividend, and set clear financial goals. And Ford, nearing its restructuring announcement on Jan. 23, saw its debt downgraded by Standard & Poor's to BB- just before the show. Meanwhile, on Jan. 10 the EPA made the road even bumpier by proposing new testing methods that will result in sharply lower mileage-per-gallon estimates.

See "Is GM on the road to a board fight?" page 35, and the new Autos Channel at www.businessweek.com/autos

Decent Job Growth The December number reported by the Labor Dept. on Jan. 6 was a shocker: just 108,000 jobs gained. But the November figure was revised up a bit. The economy's underwhelming but steady pace of job creation looks set to roll on—or even pick up—in 2007. See "One big reason to expect a decent year for jobs," page 30.

Home Depot's New Tool On beyond the big orange box: That's where Home Depot is headed. On Jan. 10, the nation's largest home-improvement retailer said it will buy Hughes Supply, an Orlando construction-supply company for \$3.5 billion. Home Depot hopes a series of recent acquisitions in the professional supply business will lay the foundation for more growth as the landscape gets crowded with its retail stores and those of archrival Lowe's.

Grilling Alito Now we see why justices get a lifetime seat. Judiciary Committee senators hammered Supreme Court nominee Samuel Alito on topics ranging from domestic spying to discrimination during hearings that began Jan. 9. Did the solons learn anything new? Not likely. The posturing could move poll numbers back home as senators figure out which way to vote later this month (Alito is expected to win confirmation). Big Business has made its mind: The U.S. Chamber of Commerce and the National Association of Manufacturers say Alito is A-O.K.

Guidant's Dilemma What to do? Dear me, what to do? Take Johnson & Johnson's sweetened offer of stock worth \$30.80 a share, more or less, plus \$37.25 in cash? Or stick with Boston Scientific guaranteed at \$36 a share plus \$30 in cash? Guidant's board is urging shareholders to go with the latter, partly to escape a \$625 million breakup fee, but now Bos-Sci has formalized its bid, it may yet triumph. Not that it is its price healthier but it has lined up Abbott Laboratories to buy Guidant's stent business, thereby avoiding antitrust suits and raising quick bucks. Guidant stockholders will decide for themselves at a special meeting on Jan. 31.

Expanding MySpace Netizens, get ready for another portal. News Corp. Chairman Rupert Murdoch rang the winning bell for Google, Yahoo!, and MSN on Jan. 9 by saying he will add search, e-mail, and even telephone service. His newly acquired social networking site, MySpace, is growing MySpace now has 47 million unique users a month, compared with Yahoo's 127 million. But never underestimate the media baron, who has a history of thrashing bigger rivals like CNN and the Big Three TV networks.

New Executive Pay Rules Two frightening numbers could start appearing in annual reports in 2007, and executives are running scared. The SEC said on Jan. 10 it will propose requiring companies to add up the total value of annual pay and benefits for top brass, while also assigning a dollar value to retirement and severance bennies.

See "The unlikely hardnose at the SEC," page 30

Dow 11,000 It has a nice ring, but can the Dow go much higher this high reached on Jan. 9 and last hit in 2001? Forces boosting the Dow are "more psychological than technical," says **Jeffrey Hirsch**, editor of the *Stock Trader's Almanac*. The market's 200-day moving average has been stuck at the 10,500 level for a year. Still, market rallies are a born of animal spirits, and the **UBS/Gallup Index of Investor Optimism** is at its highest level in 10 months.

Division at Tyco? **Edward Breen**, CEO of **Tyco International**, apparently came to the same conclusion that his jailed predecessor, **Dennis Kozlowski**, reached four years ago: Divisiveness is the best way to multiply the stock price. *The Wall Street Journal* reported on Jan. 9 that Tyco's board would vote on a plan to split the \$40 billion conglomerate into three pieces at its Jan. 12 meeting. Breen declined comment before the confab.

See "Breaking up isn't always the answer," and "Tyco: The case against a breakup," www.businessweek.com/go/tbw

Blog Dies in China Not on my site, you don't. **Microsoft** on Dec. 30 barred a blog from its Chinese **MSN** service because it rankled Beijing. When the blogosphere got wind of it, the debate over companies that help China sanitize the Net flared anew.

See "The great firewall of China," page 32

Apple Triumphant **Steve Jobs** wowed 'em at **Macworld** in San Francisco on Jan. 10, kicking off the MacIntel era by pulling a few product surprises out of his hat, and boosting of boffo iPod sales. Investors drove up the stock that day, to an all-time high of 80.86.

See "Should Apple open up?" www.businessweek.com/go/tbw

Second Career of the Week

Michael Eisner has a new happiest place on earth: **Rockefeller Center**, where the former **Disney** chief will be taping a monthly talk show for cable channel **CNBC**. Eisner, who quit under pressure last year, shed his hand as guest host for the *Charlie Rose Show*, yucking it up with friends **John Travolta** and **Barry Diller**. **CNBC** intends to draw on his star power to line up top-flight executives. "There is not going to be screaming jumping up and down on the show," Eisner told the *Los Angeles Times*. Guess that means we won't be seeing **Dreamworks CEO Jeffrey Katzenberg** or ex-supera-gent **Michael Ovitz**, both of whose tenures at Disney ended after feuds with Eisner. And certainly not board member **Roy Disney**, whose highly public unhappiness helped usher Eisner from the house that Mickey built.



MICHAEL EISNER



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CENSORSHIP

THE GREAT FIREWALL OF CHINA

How a vast security network and compliant multinationals keep the mainland's Net under Beijing's thumb

BY BRUCE EINHORN AND BEN ELGIN

SKYPE HAD A DILEMMA. The Internet telephony and messaging service wanted to enter China with TOM Online Inc., a Beijing company controlled by Hong Kong billionaire Li Ka-shing. Li's people told their Skype Technologies partners that, to avoid problems with the Chinese leadership, they needed filters to screen out words in text messages deemed offensive by Beijing. No filtering, no service. At first Skype executives resisted, says a source familiar with the venture. But after it became clear that Skype had no choice, the company relented: TOM and Skype now filter phrases such as "Falun Gong" and "Dalai Lama." Neither company would comment on the record.

It's no secret that Western Internet companies have to hew to the party line if they want to do business in China. Google, Yahoo!, and scores of other out-

fits, both domestic and foreign, have made concessions to China's censors. The latest high-profile example: In December, Microsoft Corp.'s MSN shut down a Chinese blogger's site at the government's request. Microsoft maintains it had no choice. "We only remove content if the order comes from the appropriate regulatory authority," says Brooke Richardson, group product manager for MSN.

EYES PEELED

GETTING A PHONE CALL from the government is one part of the picture. What few Westerners know is the size and scope of China's censorship machine and the process by which multinationals, however reluctantly, censor themselves. Few also know that China's censors have kept up with changing technologies, from cell phone text messaging to blogs.

How do the Chinese do it? Beijing has a vast infrastructure of technology to keep an eye on any potential online dissent. It

WHAT'S IN THIS SECTION:

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36 | Chris Cox's surprising SEC

38 | A "body blow" to stem cell research

40 | Is the Howard Stern bet paying off?



INTERNET BAR Users of Web sites, blogs, and chat rooms are monitored closely

also applies lots of human eyeballs to monitoring. The agencies that watch over the Net employ more than 30,000 people to prowl Web sites, blogs, and chat rooms on the lookout for offensive content as well as scammers. In the U.S., by contrast, the entire CIA employs an estimated 16,000 people.

Companies, both foreign and domestic, also abet the government's efforts. Virtually all Net outfits on the mainland are given a confidential list of hundreds of banned terms they have to watch for. The list changes over time, based on events such as the recent police shootings in the southern town of Dongzhou.

The rules are even tougher for companies that host their sites on servers in China. This group, which has included Yahoo but not Google, are pressured to sign the government's "Public Pledge on Self-Discipline for the Chinese Internet Industry," the U.S. State Dept. says. Under the agreement, they promise not to disseminate information that "breaks laws or spreads superstition or obscenity," or that "may jeopardize state security and disrupt social stability." Translation: "If you own something, you're responsible for what's there," says Nicholas Bequelin, a researcher for Human Rights Watch in Hong Kong. That leads companies to "err on the side of caution and self-censorship."

For those who can't see the characters on the wall, Beijing has plenty of backup. All Internet traffic entering or leaving China must pass through government-controlled gateways—that is, banks of computers—where e-mail and Web-site

Bloggers are barred from posting words like "freedom" as topics

requests are monitored. E-mail with offending words such as "Taiwan independence" or "democracy" can be pulled aside and trashed. And when a mainland user tries to open a page that's blacklisted, the gateway will simply deny access. Search for "Tiananmen Massacre" in China, for example, and 90 of the top 100 sites that mention it are blocked, according to the OpenNet Initiative, an Internet watchdog group. The Net operators' response? "We are trying to provide as much information as possible," says Robin Li, chairman of Baidu.com Inc., China's top search engine. "But we need to obey Chinese law."

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"MEAT GRINDER"

THE CENSORS ARE ALSO staying abreast of changes on the Internet. Hackers in 2004 found a list of 987 words that were banned from QQ, China's top instant-messaging program. That same year, phone companies were ordered to install software that blocks text messages with offending terms. And bloggers are barred from posting words such as "freedom" as topics, although they're given a bit more leeway in the actual text of their blog entries. Even so, since last summer, bloggers have been required either to post their musings on commercial sites that employ filters or to register with authorities, making it easier to track down offenders.

The restrictions have led many companies to make both subtle and substantial changes to their operations on the mainland. The Shanghai podcasting and video blogging service provider Toodou.com

checks files before they're posted, and users sometimes report objectionable content. And IDG Venture Technology Investment Inc., part of Boston's International Data Group Inc., has invested in Chinese company that operates only bulletin boards on real estate, entertainment, technology, autos, and more. "we don't touch politics at all," says Qi Zhou, managing director of the group's Chinese arm.

China's Internet gateways can cause problems even for those companies that avoid controversial subjects. ILX Medical Group, a Greensboro (N.C.) publisher, transmits content from the U.S. to China. But getting complex graphics through Beijing's filters can take days, says Jeff Parker, ILX's chief operating officer in Shanghai. "All traffic has to go through the same meat grinder," says Parker. "that such policies deter investors. Parker, for instance, says he's upbeat about prospects there."

Despite the power and sophistication of China's censors, the march of technology may yet foil them. As more sites offer podcasts and user-generated video, China's monitoring efforts will become more complicated because it's harder to examine such material than it is to check text files. "How do you filter when everybody has the capability to be their own video blogger?" asks Ross O'Brien, managing director at Intercedent Hong Kong, an IT consulting and research firm. "don't underestimate China's ability to control the Net, just as it has done in the past. Although the battle is far from over, the formula of getting companies to much of the fighting may keep on serving China well. ■"

Thought Police

China has the world's most sophisticated system for monitoring the Net. It can block sites and e-mail messages that criticize Beijing's policies on Tibet, the Falun Gong movement, or human rights. Here's how it works:

CHOKER POINTS All Net traffic in China has to pass through a handful of gateways where censors can check what's coming in and out. These block access to sensitive sites including CNN, the BBC, and Amnesty International.

SENSITIVE SEARCH Filters catch terms such as "democracy" or "dissident," and the results omit pages Beijing doesn't like. While censors do some of this, search engines also screen results to show only acceptable sites.

BLOCKED BLOGS Net companies keep bloggers and chat rooms within certain bounds. The government provides blog-hosting companies with banned words but lets them decide how to enforce the rules. Experts say this leads to greater censorship.



ANONYMITY, NOT Internet cafés, where many Chinese go online, must use software that stores data on each user. Similarly, bloggers must register with authorities, making it risky to write about off-limits subjects.

PEOPLE POWER China employs at least 30,000 Net cops who monitor Web sites and scour the fast-evolving Internet landscape to ferret out politically sensitive content as well as pornography and various scams.

TEXT TROUBLE In 2004 hackers discovered a list of 987 words that are blocked in the popular QQ instant-messaging program. The authorities also required phone companies to install filtering software to block offensive text messages.

POWER STEERING

IS GM ON THE ROAD TO A BOARD FIGHT?

Kerkorian may nominate directors if Wagoner keeps ignoring his advice

BY DAVID WELCH

GIVEN HIS REPUTATION for investor activism, you'd think Kirk Kerkorian might have gone to the mat with General Motors Corp. by now. Yet having amassed the third-biggest stake in GM—and lost nearly a half-billion dollars—Kerkorian has limited himself mostly to chatting with management and a few directors. And he has relied on his trusted lieutenant, B. York, to suggest, with almost German restraint, that GM move forward as it makes itself over.

Even when York took a harder line during his Jan. 10 speech on the sidelines of the Detroit International Auto Show, it wasn't his fire-and-brimstone address analysts have been waiting for. York suggested GM should consider axing brands, cutting the payroll, and whacking everyone's pay. The stock barely budged.

That raises the question: How serious is Kerkorian about forcing GM to follow his script? Will he wage a proxy fight to take control of the board? York told *BusinessWeek* that GM must take the steps he has outlined to execute a successful turnaround. He plans to

take over management in the next few months, terms to start with. Kerkorian's m.o. is to attempt a takeover of General Motors Corp. in the next few months. But York, who has been with GM since Feb. 6 to file a proxy ballot, won't rule out more aggressive action or even a proxy fight. "I hope it doesn't get tense," he says. "We're reviewing all our options."



KERKORIAN AND WAGONER

So far, relations between Kerkorian and GM have been cordial. "I always listen to a billionaire," says Chief Financial Officer Frederick A. "Fritz" Henderson. And in his speech, York offered an olive

branch: Kerkorian would buy another 24 million shares if the auto maker acts on his prescriptions.

BACK TO GOALS

BUT, IN TRUTH, the two sides disagree more than they concur. York says GM may need to sell money-making Hummer and money-losing Saab as a way to raise cash and re-size the company to

match its 26% market share. That's unlikely, say GM executives, since both brands attract affluent buyers. Another area of contention: GM's \$2-a-share dividend, which costs \$1.1 billion a year. Chairman and Chief Executive G. Richard Wagoner Jr. has refused to cut the dividend, saying it's the board's decision. And doing so could wreak havoc on GM's stock, which, at about \$22, is down 42% over the last month.

York also wants GM to set solid financial goals, something the carmaker stopped doing early last year when it became clear that huge losses were coming. Wagoner has considered giving investors a clearer picture but not until GM has sold

a controlling stake in General Motors Acceptance Corp., its financing arm, and helped pay to restructure its former parts unit, Delphi Corp., now in bankruptcy.

Kerkorian built a stake for four years at Chrysler before taking action, but most analysts believe he'll move against GM soon. So what will he do? His first option is the most peaceable—getting York on the board to influence management. He doesn't need to file a proxy to do that. But if Kerkorian feels GM is ignoring his advice, he could file a proxy ballot nominating several board members. Trying to replace the entire board is unlikely,

says Charles M. Elson, director of Weinberg Center for Corporate Governance at the University of Delaware: "The question [then would] become whether Kerkorian can run a car company."

Much will depend on how much support Kerkorian can get from other big shareholders. So far none will say if they would be willing to back him should a proxy battle erupt, but analysts contend that he could probably garner enough support to get some like-minded directors on the board. "GM has historically been a slow mover that has not had to deal with an outspoken, large shareholder," says Brian Ropp, a credit analyst with T. Rowe Price Group, which owns 4.3 million GM shares. So far, Wagoner & Co. seem disinclined to take Kerkorian and York's advice. ■

—With Roben Farzad in New York

THE STAT

\$480 million

The amount Kerkorian's GM investment is under water, including a net loss on 12 million shares sold in December

Data: BusinessWeek

INVESTING

THE UNLIKELY HARDNOSE AT THE SEC

Now Chris Cox wants all CEO pay revealed
—as he keeps delighting shareholders

BY AMY BORRUS

SHOWING A VISITOR AROUND his airy office at the Securities & Exchange Commission, Chairman Christopher Cox breezes past photos of his family to pick up a framed check for \$3.36 made out to "C.C. Cox." Dated Dec. 15, 1944, it is all the restitution the SEC chief's grandfather received after losing securities worth \$6,000 in Insull Utility Investments Inc. Insull, the Enron of its day, collapsed in the 1930s—a debacle that fueled the drive to create the SEC.

For Cox, the weathered memento is a touchstone. "My grandfather, who died a few years before I was born, framed the check because it was worth more as a painful lesson," the chairman says. "It serves as a reminder that the SEC's mission of investor protection is about individual Americans, their life savings, and their hopes and dreams."

So much for the widely held assumption that Cox, a Southern California Republican who steadily supported business interests for 17 years in the House, would loosen the reins on Big Business. Since his arrival at the SEC in August, Cox has championed investor protections. He resisted pressure to roll back key reforms for mutual funds, hedge funds, and employee stock options. And insiders say he has voted consistently to impose tough penalties on wrongdoers. Next, on Jan. 17, the SEC chief will unveil proposals that would force companies to spell out top executives' pay, perks, and retirement benefits in clear dollar terms.

Shareholder advocates are delighted by Cox's unexpected investor-friendly moves. "I have been pleasantly surprised on a number of fronts," says Barbara Roper, director of investor protection at Consumer Federation of America.



A Series of Surprises

In the House, Cox steadily supported business interests, but he is emerging as a pro-investor SEC chairman:

CEO PAY The SEC will propose new rules on Jan. 17 forcing companies to spell out executive pay, perks, and benefits in clear dollar terms

STIFF ENFORCEMENT Insiders say Cox votes consistently for tough penalties, and he forged agreement on new standards that ensure corporate wrongdoers get stiff fines

POST-ENRON REFORMS Despite business pressure, the SEC chief says he won't undo reforms established under his predecessor that impose tighter controls on mutual funds, hedge funds, and employee stock-option expensing

Cox insists he hasn't changed stripes. He says his tell-all pay rules are sync with free-market principles. "Figuring for better information for investor entirely consistent with the promotion economic growth," he says. Cox, 53, no instinctive sympathy for megabuck CEOs. Some 20 years after he left his crative practice in securities law, earned \$162,100 in the House and maelless—\$149,200—as SEC chief.

"MORE GIVE AND TAKE"

THE FORMER CONGRESSMAN'S political skills have pulled his four colleagues into accord. Under his predecessor William H. Donaldson, Republican Commissioners Paul S. Atkins and Cynthia Glassman rebelled against what they saw as overkill in regulation and enforcement. Agency insiders say Cox works assiduously to build consensus, casting a veto net for ideas. "There's much more give and take" in discussions, says Atkins. Under Donaldson, 8 to 10 officials attend the weekly senior staff meetings on Tuesday days at 8:30 a.m. Cox has opened the sessions to more than 20 aides.

To bridge a partisan divide over whether the SEC should fine corporations, Cox let commissioners hash out the issues for hours. The upshot: unanimous agreement to seek penalties when a company has profited from its violations and punishment could deter other companies. Still, the principles are general enough that specific cases could remain contentious. "There's a fair amount of give and take there," says former SEC Commissioner Harvey J. Goldschmid.

Not enough to satisfy business critics who complain that the agency is a roughshod over corporate defendants. And Cox can expect business to balk at bare-all CEO pay proposals. A key sticking point will be a mandate to assign a dollar figure for retirement and severance packages. "There's concern that numbers will be viewed as set in stone rather than as estimates based on assumptions," says Mark Borges, a principal at Mercer Human Resource Consulting LLC.

To maintain his investor-friendly image, Cox needs to follow through. He must fill key jobs at the agency, pick top overseers for mutual funds, trading, and financial disclosure, and as naming a new head for the accounting oversight board. But by starting out with a pro-shareholder note, Cox has earned goodwill that could help him cut through some slack later. ■

—With Mike McNamee in Washington



CORPORATE CASES

JUST SAYING 'NO' TO UNCLE SAM

The backlash against prosecutors coaxing companies to waive attorney-client privilege

BY LORRAINE WOELLERT

WHEN RICHARD Hawkins, former chief financial officer of McKesson Corp., was indicted for securities fraud, prosecutors had some daunting weapons in their arsenal. To develop their case, they had relied heavily on an internal investigative report prepared by Skadden Arps, a law firm retained by McKesson after an accounting scandal engulfed the health-care services company. And at Hawkins' trial last year, Skadden lawyers took the stand to help the government make its case against him.

Hawkins was acquitted in July, 2005, but McKesson's cooperation with the government highlights a matter of growing concern to executives: a fear that they may not be able to trust their own company's lawyers. The root of the problem,

according to business advocates, including the U.S. Chamber of Commerce and its allies, is that prosecutors pursuing corporate wrongdoing increasingly are pressuring companies to waive attorney-client privilege if they want to avoid indictment or big fines.

Corporate Cooperators

Here are some companies that have curried favor with the government by waiving the attorney-client privilege

ABB LTD. Paid a **\$10.5 million** fine in July, 2004, after alerting Justice to possible bribes paid by its overseas affiliates. Agreed to provide "real-time disclosure" of the results of an internal investigation.

COMPUTER ASSOCIATES Justice deferred prosecution in September, 2004, after the company waived privilege and agreed to pay **\$225 million** in restitution.

Now a coordinated lobbying effort to rein in this prosecutorial tactic is under way in Congress, at the U.S. Sentencing Commission, and at the U.S. Justice Dept. The campaign has garnered little attention, but it is a critical part of a broader backlash against the 2002 Sarbanes-Oxley Act (page 94) and other tough laws enacted in the wake of Enron and a cascade of similar accounting scandals. Among those joining the crusade are former Solicitor Generals Theodore B. Olson and Kenneth W. Starr, along with onetime Attorneys General Edwin Meese III and Dick Thornburgh.

"AGENTS OF THE GOVERNMENT"

CORPORATIONS ARE FREE to waive attorney-client privilege—the legal rule that protects communications between a lawyer and a client—because their lawyers work for the company, not individual employees. While that presents an opportunity for investigators, civil liberties groups and business interests see cause for concern. "You're making corporations the agents of the government," says Tracy A. Miner, head of the white-collar defense group at Boston's Mintz, Levin, Cohn, Ferris, Glovsky & Popeo.

Companies, eager to play nice with the feds, are complying, which can set up employees to take a hit. Notes of conversations with company counsel that employees assume to be confidential are readily handed over to investigators, and company-commissioned investigations by lawyers and accountants are coughed up to prosecutors. As a result, class-action attorneys filing private suits frequently get their hands on the material, too, creating a big-money headache for companies in trouble.

Regulators and prosecutors long have sought so-called privilege waivers, but their use started to expand three years ago when then-Deputy Attorney General Larry Thompson penned a memorandum

MONSANTO Paid a **\$500,000** fine and agreed to turn over internal documents to avoid indictment under the Federal Corrupt Practices Act in January, 2005.

TAP PHARMACEUTICALS Paid **\$875 million** in October, 2001, to settle drug pricing charges. Also turned over results of its internal investigation, leading to the indictment of several executives.

detailing things corporations could do to win brownie points and steer clear of prosecution. Waiving attorney-client privilege was on the list. In November, 2004, the Sentencing Commission issued guidelines giving companies that waive privilege a big break on the size of their fines.

During the past year representatives from the Chamber of Commerce, the American Bar Assn., and the American Civil Liberties Union have met with Justice officials, including acting Deputy Attorney General Robert D. McCallum Jr., to air their concerns. The coalition, which includes the National Association of Manufacturers and a host of other trade groups, also has bombarded the Sentencing Commission with letters and testimony, urging the panel to revisit its 2004 guidelines.

Sentencing Commission members and the Justice Dept. say there's no hard evidence that waiver requests are on the rise and suggest that business is relying on vague anecdotes to make its case. "Justice is not aware of any instance

Justice says there's no hard evidence of strong-arm tactics

in which the waiver request process has been misused," McCallum said in a written statement to *BusinessWeek*. Nonetheless, he ordered prosecutors on Oct. 21 to establish oversight of waiver requests.

Although his directive was a small victory for business, some corporate lawyers worry that it leaves too much discretion in the hands of prosecutors.

Lobbyists already have the attention of Senate Judiciary Chairman Arlen Specter (R-Pa.), who recently chastised Justice for relying on corporate investigators to undertake the department's legwork. "If the Department of Justice wants to prosecute a company, the Department of Justice has the burden of proof," Specter said in a November speech to a room full of white-collar defense lawyers. "I wouldn't waive my attorney-client privilege if I were you under any circumstances." Business is also urging House Judiciary Committee Chairman F. James Sensenbrenner Jr. (R-Wis.) to hold hearings on the subject this spring, which would give it an opportunity to air its grievances on a broader stage. ■



FIGHTING FOR LIFE
Shares in Lanza's ACT have stalled

BIOTECH

A 'BODY BLOW' TO STEM CELL RESEARCH

Funding in the U.S. wasn't so hot even before the Korean scandal broke. Now..

BY ARLENE WEINTRAUB

ON A RAINY DAY IN Worcester, Mass., just before New Year's, Dr. Robert Lanza threw his arms up in despair. He had just heard initial reports that South Korean scientist Hwang Woo Suk faked 11 lines of embryonic stem cells he claimed to have created through cloning last May, with the results published in the prestigious journal *Science*. Lanza is vice-president of medical and scientific development for Advanced Cell Technology Inc., one of the few publicly held U.S. companies that are researching embryonic stem cells. He fears that Hwang's fabrication, which was confirmed on Jan. 10, will set the already embattled field back indefinitely. "The reputation of the science has suffered," Lanza laments.

The Korean debacle is a black eye that America's stem cell pioneers can ill afford. Federal funding is still limited to research on just a few batches, or "lines," of the embryonic cells. And the promised \$3 billion in funding from California's Proposition 71 is tied up by lawsuits challenging its constitutionality. The political

overhang has kept most venture capitalists away from anyone with the phrase "stem cell" in their business plan. When the Korean scandal started erupting in December, shares of ACT fell 16% and rival Geron Corp. tumbled 4%, despite the fact that interest in biotech was still high and the Amex Biotech Index was up in the same period. Korea "is just another body blow," says ACT investor William Woodward of Santa Monica (Calif.)-based Anthem Venture Partners.

As the custodians of academic research, journals such as *Science* and *Nature* take some responsibility for the tight purse strings. *Science* previously said it would withdraw Hwang's May 1 paper, and on Jan. 10, the magazine said it would withdraw a 2004 paper by Hwang as well. Both papers, like many in well-known journals, were "peer-reviewed," meaning they were critiqued by two or more independent scientists before they were published. But the review clearly was inadequate, and *Science* Editor-in-Chief Donald Kennedy has said a statement that the journal will cover "additional procedural safeguards."

In the tiny world of stem cell research, that's a scary message. Because con-

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cial stem cell products are still far out on the horizon, biotech investors depend on peer-reviewed reports when deciding where to place their bets. Any reduction in papers published could crimp the ability of stem cell companies to raise funds. "This is certainly a wake-up call for peer review," says Geron CEO Thomas Okarma.

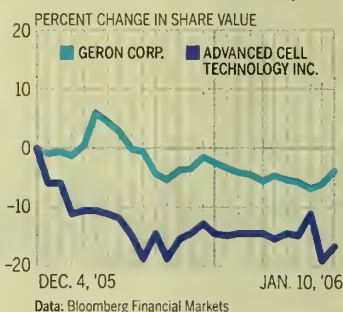
Geron's recent history reveals how much is at stake. On Sept. 1, the Menlo Park (Calif.) company announced that cardiac-muscle cells derived from human embryonic stem cells survived and multiplied in the hearts of rats, suggesting the cells might someday be useful for treating cardiac disease in humans. The research was published in the *American Journal of Pathology*. Geron's stock immediately traded up 3%, to \$11.20, on four times its normal trading volume. Such share-price bumps have allowed the company to go back to investors in a position of strength: It now has \$200 million in cash and no debt.

REPEATED SNAGS

THE LONG-TERM impact of Hwang's deceit on science publishing remains unclear. Some scientists, including ACT's Lanza, felt

TROUBLED TIMES

U.S. stem cell stocks have tumbled since the Korean scandal erupted



fighting for its life. West, who joined the company after leaving Geron in 1998, struggled to gain the confidence of deep-pocketed investors. Meanwhile, across the Pacific, the Korean government was funneling dough into labs such as Hwang's, giving U.S. investors the impression that ACT had fallen hopelessly behind.

This led to some contortions. When ACT decided to raise money by going public last year, investment bankers were so uninterested that the company opted instead to reverse-merge into a shell company that once made Hopi Indian dolls. It wasn't quite as splashy as an initial public offering, but the symbolism was perfect: The dolls represent ancestral spirits to whom the Hopis pray for rain and other gifts. New shares in hand, ACT raised \$18

million from hedge funds and other risk-taking investors—enough to carry company into 2007. But the spirits did smile on this stock, which fell from a high of \$7 to a recent \$1.90 a share.

Lanza says the stem cell flap hurts the most. He often thinks about the incident in 2004 when a police officer allowed him to work. Lanza thought he was about to get snared for speeding. But the cop just wanted an update on ACT's search. One promising project was using stem cells to make retinal pigment epithelial (RPE) cells, which the eye needs in order to see. The policeman's teenage son was suffering from a degenerative eye disease and was about to go blind. "I was in tears," Lanza says. "We didn't have money to keep the cells going." Thanks to fresh capital from the Hopi doll company merger, that research is back on track. Red Tailed Hawk doll sits in Lanza's office, reminding him of the strange reversal of fortune that reinvigorated ACT. Hwang's lab has crumbled, notes Lanza, and "we're still alive."



FALLOUT Hwang's deceit could shake up peer review

IS HOWARD WORTH IT?



Shock jock Howard Stern started his new gig at Sirius Satellite Radio on Jan. 9. The superstar, with 12 million loyal listeners on broadcast radio, is getting big bucks in cash and stock over five years. A quick, back-of-the-envelope calculation looks like Sirius will see a return on its investment well before the five years are up:

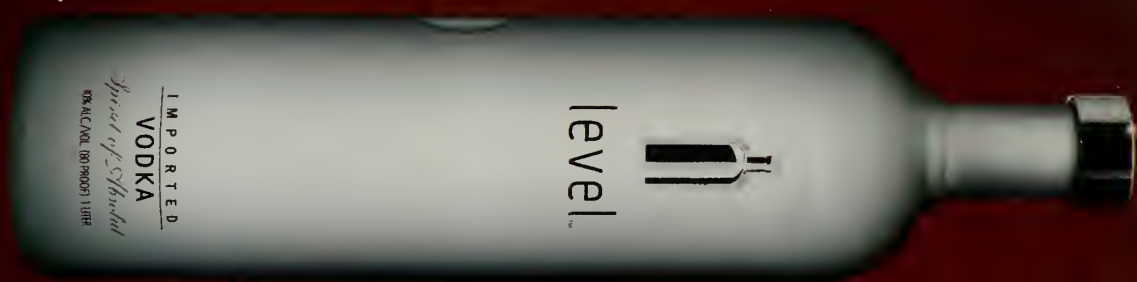
1.25 million	* Projected number of subscribers who will join Sirius because of Stern in 2005 and 2006
\$137.5 million	The amount those subscribers pay per year based on annual fees of \$110, subtracting variable costs
\$687.5 million	What those "Howard subscribers" will pay over five years, the length of a Sirius subscription based on monthly turnover rates
\$500.0 million	Stern's payout in cash and stock over five years
\$187.5 million	What's left after his total pay package
\$137.5 million	What it costs Sirius to acquire those "Howard subscribers" based on acquisition costs of \$110 per sub
\$50.0 million	The profit based on subscribers through 2006. Any subscription growth above that adds to the gains

* Assumes that half of the 2.5 million additional subscribers projected to sign on in 2005-2006 will be due to Stern

WHAT'S MORE... The Howard effect could also bring in a large chunk of new ad dollars. The company projects that 10% of revenues, about \$60 million, will come from all ads in 2006.

Data: Business

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RICHARD S. DUNHAM

The Struggle to Sell The Economy's Sizzle

AS THE KIND OF BLUNT FEEDBACK the White House rarely receives. In a recent conference call with business allies, one prominent lobbyist lamented the disconnect between upbeat economic statistics and the sour public mood. "Why aren't you people glorifying the obvious?" he asked. "This is a great economy."

Message received. The Bush Administration has gone into public-relations overdrive to talk up the good economic news. On Jan. 6, President George W. Bush underscored positive employment and growth numbers in a speech before the Economic Club of Chicago. With gross domestic product rising at a rate in the third quarter, "the American economy heads into 2006 with all head of steam," he declared. Deputies from Treasury Secretary John Snow at the New York Stock Exchange to Assistant Labor Secretary Victoria Lipnic at Brett Beckett's Steakhouse in Menomonee Falls, Wis., fanned the message across the nation to help home the message.

Wipeout

THE PRESIDENT'S BUSINESS friends have had reason to spread economic cheer. They want Bush to pass the stalled business agenda: locking in the 2001 and 2003 tax cuts, reforming the legal system, and negotiating trade pacts. That's a tall order without an uptick in public confidence. Corporate lobbyists also fear that angst over Iraq and anger at Washington's burgeoning lobbying scandal could lead to a GOP wipeout in November's midterm elections, especially if public anxiety over the economy lingers. "We have not done a very good job of getting our message out," Allan B. Hubbard, the President's top economic adviser, told *BusinessWeek*. "We have to keep reminding people that this is a remarkable economy."

White House officials acknowledge they are slow to address the perception gap. Hurricane Katrina "distracted the econom-

ic team," concedes one senior Bush aide. Officials say they couldn't boast of a stellar economy as the Gulf Coast struggled to recover. And the post-Katrina spike in gasoline prices fueled widespread pessimism.

Now the President is highlighting a 4.9% unemployment rate, 400,000 new jobs created in the past two months, and 3.5% annual productivity growth since he took office. But aides acknowledge that such good news is overshadowed by massive layoffs at General Motors, airline bankruptcies, and corporate pension woes.



SPREADING THE NEWS Bush is talking up 400,000 new jobs in the past two months

"Job cuts are on page A1 and job increases are on D1," says White House Deputy Press Secretary Trent Duffy.

To move the good news to the front page, the White House decided that it needed a sustained commitment from the Persuader-in-Chief. "When he talks about it, it's national news," says Bush outside adviser Charlie Black. But there's plenty of work to do. A Jan. 5-8 CBS News Poll found that just 20% of Americans think the economy is improving, while 37% believe it is worsening and 43% say it is unchanged.

Democrats say Bush's happy talk is out of sync with such financial realities as soaring costs for tuition, health care, drugs, and heating. Charges Senator Charles Schumer (D-N.Y.): "For the Administration to be out there saying things are great shows just how out of touch they are with the average American." Hubbard says the President knows that Americans are squeezed by high energy and health costs. But he says Democrats would hurt struggling families more by letting tax cuts expire. In the end, the White House is betting that the real answer to its PR problems is an increasingly vibrant economy. ■

ON THE RECORD

'I'D MUCH RATHER BE IN OUR ECONOMY TODAY'

ALLAN B. HUBBARD, the Bush Administration's top economic salesman, is a Harvard Business School classmate of Bush and a former CEO. The director of the National Economic Council sat down with *BusinessWeek* correspondents Richard S. Dunham and Howard Gleckman on Jan. 11.

A lot of middle-class people feel a financial squeeze. How can the Administration deal with that?

That's definitely a concern. Health care has been gnawing away at people's wage increases for the last 20 years and has become a much bigger problem in the last five. Health-care costs are a crisis in America, and the President is very concerned about that.

What can he do about it?

He's looking at a number of very important things. The source of the whole problem is third-party pay. The result has been overutilization [of medical services] and no pressure on pricing. We've got to get the individual who is consuming to know what the prices are and [to] have some skin in the game. Employers should insist that their insurance companies provide information so people are much better consumers.

How good do you think the economy is, compared with the booms of the late '90s or '80s?

I'd much rather be in our economy today than the '90s or the '80s. The problem with the '90s was there was excess. We knew it, but we just thought it was going to continue. It wasn't sustainable. What's wonderful about this economy is that it's broad-based and very sustainable. It's strong growth but not too strong, so it's not going to be a boom-and-bust situation.

CHINA

YEAR OF THE CITI?

Its bid for an insolvent Chinese bank could change the banking game in China in its favor—big-time

BY BRIAN BREMNER

IT HAS BEEN THE MATING OF the mighty with the mighty. Some of the world's biggest commercial and investment banks, including HSBC Holdings, Goldman Sachs, American Express, the Royal Bank of Scotland, and Bank of America, have spent billions buying strategic stakes in China's biggest financial institutions, including China Construction Bank, Bank of Communications, and Bank of China. The Westerners want access to Chinese depositors and their savings of \$1.8 trillion. They also want to help China's biggest banks go public, and enrich themselves in the process: The initial offering of China Construction has already made a ton of money for BofA. Now, Bank of China has just gotten the government nod to raise \$8 billion later this year. That will fill the bank's coffers and hugely benefit its key American partner, Merrill Lynch & Co.

But someone's missing from the dance card: Citigroup, a bank with ties to China dating back to 1902 in Shanghai, and a record of making big bets in expanding markets such as Mexico. Citi has balked at signing on to big partnerships with the Chinese majors (it pulled out of negotiations with China Construction Bank last year, for example). It has always insisted on having a big managerial voice, which is something the major mainland banks are reluctant to give away. As a result, all Citi has to show for its efforts in China is about 5% in midsize Shanghai Pudong Development Bank, for which it ponied up a paltry \$67 million in 2003.

Now Citi is hoping to hear in the coming weeks from Chinese authorities on a bid it made in October for another regional player, Guangdong Development Bank. Just another consolation prize? Maybe not. The unusual thing about the Guangdong bid: Citi and a group of in-

vestors including The Carlyle Group, a U.S. private-equity firm, want 85%. Acquiring outright majority control of a Chinese bank would be a first for a foreigner, and possibly prove to be a game-changer.

Citi needs a bold play. True, it has made some headway, expanding its own branded network of retail branches as well as outlets that focus on corporate lending and investment banking services. Two years ago it joined with Shanghai Pudong to launch a successful dual-currency credit card that customers can use to pay in yuan at home or in foreign currencies abroad. Last September, Citi forged a tieup with China Unionpay Co., a national bank-card association, which gave Citi cardholders access to its partner's vast ATM network on the mainland. Andrew Morse, managing director and chief executive of Citi's Asia Pacific Corporate & Investment Bank, told ana-

lysts late last year that Citi's branch businesses in China are not only "highly profitable" but have delivered 39% average annual growth rates over the past three years.

CHARM OFFENSIVE

YET MAINLAND CHINA generates 2% of Citi's Asian revenues, vs. 12% from Hong Kong, 14% from South Korea, 10% from India—all smaller economies than China's. Citi's Asian operations generated an impressive \$2.6 billion in earnings in 2004 (bigger than Lehman Brothers Inc.'s worldwide profit) on \$7.6 billion in revenues. Those numbers would be even more robust if Citi could manage to develop a sizable mainland presence.

So now Citi Chief Executive Charles Prince III has given the green light to a more aggressive China strategy. The New York behemoth is leading a group

wants to pay some \$3 billion to acquire control of Guangdong Development, a commercial lender that's been insolvent after years of extending credits to favored companies. On the plus side, the ledger, though, Guangdong is based in Guangzhou, right smack in the country's second-richest province where all foreign players want to be. Better yet, it has a plus branch network. To take the bank, Citi will need a special exemption from Beijing. The 20%-to-25% investment caps imposed on foreign investors, something its U.S. and Western government have long pressured Chinese President Hu Jintao's government to do.

To win its bid, Citi launched the usual cor-

Slow Start

Citibank has been out-hustled by rivals HSBC, Bank of America, and Goldman Sachs in cinching deals with big Chinese banks. Here's how it plans to catch up:

ACQUISITIONS Citi is paying \$800 million to boost its stake in Shanghai Pudong Development Bank to nearly 20% from about 5% and is leading a \$3 billion bid with U.S. and local partners to buy 85% of Guangdong Development Bank.

CONSUMER BANKING Playing catch-up with HSBC, Citi is still expanding its branch network. It now has 10 consumer Citibank outlets in China, including one in the western city of Chengdu that opened on Dec. 26.

CORPORATE CLIENTS Citi is a big player in syndicated lending and other services to 1,700 Chinese companies, but it wants to expand its investment banking operations with more merger advice.

citibank

花旗银行



FAST GROWTH Citi's
revenues in China are
growing 39% a year

an offensive waged by Prince and
Robert E. Rubin, former Treasury Secre-
tary and Citi director and door-opener-at-
large, who have personally lobbied Chi-
nese officials. Its main argument is that
China needs to rescue Guangdong. At
least 20% of Guangdong's loan book, or
about \$6.2 billion by some estimates, is
not performing. That burden is roughly
three times larger than Guangdong's en-
capsulated base. "The problems at this
bank run very deep," says May Yan, vice-
president and senior analyst with
Citi's Investors Service in Hong Kong.
And while the central government has
injected \$259 billion into big national
state-owned banks to clean them up, it
has been reluctant to do costly salvage

jobs on regional lenders
like Guangdong. Guang-
dong officials don't want
to touch the bank, either.
That official aversion to a
bailout could tip the
balance in favor of Citi,
even though it still faces a
rival bid from Société
Générale of France and
domestic bidders.

If the deal goes
through, Citi will suddenly
have a key advantage over those globe-
girdling rivals like HSBC who have bested
it in China so far. It will have carte
blanche in turning around Guangdong
and won't have to contend with all the po-

Acquiring majority control of a bank would be a first for a foreigner

also have this opportunity," he says. It's
not the biggest deal of 2006. But if Citi
bags Guangdong, it could be one of the
most important. ■

—With Dexter Roberts in Beijing

litical considerations and in-
stitutional resistance that
foreign minority investors
have had to deal with at other
Chinese banks. Citi would
install its own management
team, while a booming
coastal economy would likely
mean continued double-digit
growth in customer deposits.

Guangdong, established in
1988, would certainly need a
complete overhaul in lending
practices, information tech-
nology, and customer service.
But once it cleaned house,
Citi could make a go of dis-
tributing its array of loan
and credit-card products and
build a nationwide branch
network. In contrast, Bank of
America doesn't have man-
agerial control of China Con-
struction—and it had to
abandon its ambitions for its
own mainland retail strategy
to secure the partnership
with CCB.

The attractions for Citi
aren't just on the retail front.
It could also lure the bank's
corporate clients to its invest-
ment banking services,
which already have a track
record on the mainland. Citi,
for instance, scored big by
providing merger advice and
underwriting services for
China National Petroleum's
\$4.2 billion buyout of
PetroKazakhstan Inc.

Acquiring control of
Guangdong will change the
field in other ways. If Citi
wins the approval it covets,
other foreign banks are cer-
tainly going to demand a
wholesale lifting of the 20%
cap on their current and fu-
ture deals. Song Guoqing, an
economics professor at Bei-
jing University's Center for
Economic Research, thinks a
successful turnaround at
Guangdong could also give
Chinese officials political
cover for more such
takeovers. "If this went well,
other [foreign] banks might

'Killer Coke' or Innocent Abroad?

Controversy over anti-union violence in Colombia has colleges banning Coca-Cola

BY DEAN FOUST AND GERI SMITH

IT'S EARLY MONDAY MORNING, but Ray Rogers has the full attention of some 70 students in a Rutgers University classroom. For nearly half an hour, the 61-year-old labor activist rails against Coca-Cola Co., taking the beverage giant to task for allegedly turning a blind eye as eight employees of Coke bottlers in Colombia were killed and scores more were threatened or jailed on trumped-up terrorism charges over the past decade. "The reality is that the world of Coca-Cola is a world of lies, deceptions, corruption, gross human rights and environmental abuses!" thunders Rogers, a legendary union activist who cut his teeth organizing a highly publicized campaign against textile maker J.P. Stevens & Co. in the 1970s. He slams his hand on a desk. "But this is where it's going to stop! We're going to put an end to this once and for all! How many of you will stand up against Coke?" One by one, roughly half the students lift their hands. In response to Rogers' charges, a Coke spokeswoman says the activist "has no facts to support his claims."

Despite the vast generation gap and Coke's rebuttals, Rogers' diatribes are starting to resonate on campuses from New Haven to Ann Arbor, where his "Killer Coke" campaign has become the latest cause célèbre among student activists—"the new Nike," as one puts it. At dozens of schools, small but feisty groups of students have demonstrated against the company—like the ones who staged a "die-in" during a 2004 Yale University speech by then-CEO Douglas

N. Daft. Already, about 20 colleges in the U.S. and abroad have halted sales of Coke on campus, in part over the Colombia controversy.

In December, Rogers bagged his two biggest victories to date when New York University and the University of Michigan banished Coke. For two years, NYU student activists had demanded an independent investigation of worker conditions in Colombia. "The students felt it has been two years, and nothing's been



done," says Arthur Tannenbaum, a faculty spokesman at NYU. In response, a Coke spokesperson says the company would accept an outside review, but only if the findings aren't admissible in a lawsuit filed in Miami by the International Labor Rights Fund on behalf of the slain Colombian workers—a condition the ILRF has not accepted.

PICKING UP STEAM

COKE OFFICIALS MAINTAIN that the company has been unfairly tarred by union activists who have distorted the facts about Colombia. Perpetuating "urban myth is more exciting [for activists] than knowing what the facts are," says Edward E. Potter, a longtime corporate la-

bor lawyer who joined Coke as global labor relations director last March. Coke officials say only one of the eight workers was killed on the premises of the Coca-Cola bottling plant owned by Bebidas y Alimentos de Urabá. Also, they say, the other deaths—which all occurred off-premises—were byproducts of Colombia's four-decade-long civil war among left guerrillas, government forces, and paramilitaries, which has resulted in at least 35,000 deaths, including 2,500 trade unionists since the mid-1980s alone.

What's more, an important global coalition of labor unions has refused to support Rogers' anti-Coke crusade, which seeks reparations for the families of victims. "We have no evidence of complicity by Coke in the killing of workers," says Ron Oswald, general secretary of the International Union of Foodworkers in Geneva, whose members include tens of thousands of Coke workers worldwide. Some government and union leaders believe that the militant union leading the crusade, SINALTRAINAL, a Colombian union of food-industry workers known for its socialist views, has zeroed in on Coke as a way to get the broader issue of union violence heard around the world. "Out of one killing they built up a ca-

DEATH THREATS Former union president Manco has been hiding for nine years

ampaign," says Colombian Vice President Francisco Santos Calderón. "In the end, the only way to stop hurting Colombia" by making it seem like a dangerous place to do business.

Still, Rogers seems to be picking up steam. The activist says he has been contacting students at more than 100 other colleges looking to initiate similar protests, including Washington Georgetown University and Atlanta Emory University, whose endowment includes large holdings of Coca-Cola stock. Rogers also believes he can score a win in Britain in the coming months when the National Union of Students is purchasing co-op for more than 200 student unions there, debates whether to renew Coke's beverage contract.

The college deals—collectively worth perhaps a few million dollars—represent a negligible loss of business for the billion soft-drink titan, which now generates 85% of its operating income outside the U.S. But the campaign is heating up at an awkward moment for

Workers say paramilitaries forced them to sign a letter—on the bottler's stationery—resigning from the union

Cola, which was recently eclipsed by PepsiCo in market value. Plus, Coke is pinning a revival on a new marketing plan set to launch in the spring around the theme "Welcome to the Coke Side of Life." "I know the impact we're having on Coke, and I know it's getting worse," says Rogers.

Beyond bad PR, the Colombia controversy illustrates the challenges facing all multinationals that do business in unstable places. As Nike Inc. learned in its recent sweatshop labor flap, companies are increasingly being held accountable for everything that occurs all the way through the supply chain, even when it involves independent contractors, as is the case with Coke and its Colombian bottlers. In the end, some crisis-management experts believe Coke may be able to defuse the Colombia situation only by consenting, as Nike did, to an outside review, and by taking public steps to better ensure the safety of bottling company workers in countries such as Colombia. "You just can't...say: 'They're the bottlers, we just sell the syrup,'" says Edward F. Ahnert, a former president of ExxonMobil Foundation who teaches corporate social responsibility at Southern Methodist University's business school.

BREAKING THE UNION

WHAT HAS TRANSPIRED in Colombia over the past decade is a matter of debate. According to union leaders from SINALTRAINAL, on whose behalf the 2001 Miami lawsuit was filed, several years of violence and killings of Coke workers intensified on Dec. 5, 1996, when a right-wing paramilitary squad showed up at the gate of the Coke bottling plant owned by Bebidas y Alimentos in Carepa, a small town in northwestern Colombia's banana-growing region. The paramilitaries shot and killed Isidro Segundo Gil, the gatekeeper and a member of the union's executive board. An hour later they kidnapped another union leader at his home and torched the union's offices.

The following day the paramilitaries returned to the plant, called workers together, and gave them until 4 p.m. to sign a

STEPHANIE DZICZEK/VALE DAILY NEWS

N" Coke's
EO Daft
ng at Yale
4 amid
protests

Coca-Cola in Colombia: A Timeline

JULY 30, 1990 First Coke bottling-plant worker in Colombia killed, with a shot to the head, during a strike for better working conditions in Nariño, in the southwest. The victim was on the local union board of directors.

1994-95 Three more Coke workers killed, all of whom were employed at the Carepa plant in northwestern Colombia.

DEC. 5, 1996 Right-wing paramilitaries storm the Carepa plant, killing a worker, then kidnap a union leader from his home and torch the union's offices. They return to the plant the next day, demanding that workers sign a statement resigning from the union—or else—and order top union leaders to leave town “if you want to live beyond today.”

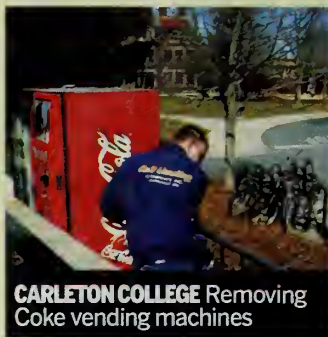
JULY 20, 2001 The United Steelworkers and the International Labor Rights Fund file suit in Miami on behalf of the SINALTRAINAL union in

Colombia, naming Coca-Cola and two of its Colombian bottlers as defendants. A judge later dropped Coke from the suit, leaving the bottlers as defendants.

APR. 16, 2003 Labor activist Ray Rogers launches his “Killer Coke” campaign at Coca-Cola's annual meeting in Houston. Months later, Bard College in New York becomes the first U.S. school to not renew its beverage contract with Coke because of the controversy.

APR. 13, 2005 Coca-Cola releases a study it commissioned by consultant Cal Safety Compliance that found no instances of anti-union violence or intimidation at Coke bottling plants in Colombia.

DECEMBER, 2005 New York University and the University of Michigan become the latest colleges in the U.S. and abroad to ban Coke products from their campuses.



CARLETON COLLEGE Removing Coke vending machines

statement resigning from the union on stationery the unionists claim bore the bottler's letterhead—or else. Many union members resigned on the spot; 27 even quit their jobs and fled to other cities, fearing they would be killed if they stayed. Luis Hernán Manco, who was president of the union at the time, was summoned by the plant manager to a local tavern, where several paramilitaries warned him and other union leaders to leave town. “They said: ‘If you want to live beyond today, get out of this area.’ I knew they were serious,” recalls Manco, now 59, who has been in hiding for nine years. For two more months, union leaders claim, the paramilitaries camped outside the front gate of the Carepa plant.

The union alleges that Coke and its local bottler were complicit in these acts. (Both companies deny the charge.) Among the claims made in the lawsuit is an alleged 1996 public statement by Ariosto Milan Mosquera, the plant manager at Carepa, that “he had given an order to the paramilitaries to carry out the task of destroying the union.” (The plant's owner, Richard Kirby of Key Biscayne, Fla., denies his managers gave any such orders.) Over the intervening nine years, in addition to the eight who died, 48 others have been forced into hiding, and 65 have received death threats, SINALTRAINAL leaders say. In Bucaramanga, a midsize city in northeastern Colombia, five union members who work at the Coke plant there were jailed for six

months in 1995 on terrorism charges that were later dropped for lack of evidence. They were accused of planting an explosive device in the plant, but three of them who spoke to *BusinessWeek* said they doubt such a device ever existed.

Union leaders insist Coke could have halted the violence by immediately—and publicly—repudiating the paramilitaries. “If the company had condemned the first death, there probably wouldn't have been any more,” says Edgar Paez, director of international relations for SINALTRAINAL. A Coke spokesman disputes that. “Our bottlers have been quite open in condemning the violence,” he says, pointing to local newspaper ads they published that denounced the violence. Paez also claims

the Coca-Cola bottler financially benefited from the paramilitaries' actions, since they broke the union and allowed the bottler to replace many of its full-time employees with much cheaper part-time and temporary workers. Plant owner Kirby denies that charge and says he suffered, too: His wife's sister was kidnapped by the paramilitaries, who also burned four of his trucks and tried to coerce Kirby into selling his plant to them on the cheap, which he declined to do. “Nobody tells the paramilitaries what to do. They tell you,” he says.

There's no clear path for Coke to mitigate the controversy. Nike, after its initial reluctance to engage its critics, was able to resolve the allegations that it used sweatshop labor; the sneaker giant im-

“Urban myth is more exciting [for activists] than knowing what the facts are.”

—Edward E. Potter,
Coke's Global Labor
Relations Director

posed tougher workplace standards on suppliers and invited outside group help monitor their compliance. In April, Coke released the results of a study by Safety Compliance Corp., a Los Angeles consultant that specializes in workplace audits, which found no current instances of anti-union violence or intimidation at Coke bottling plants in Colombia. Union activists and students were moved, since Coke had paid for the study, and demanded that the company agree to an independent investigation of its Colombian operations. At first, Coke said yes, but the plan hit an impasse over the findings' admissibility in the ongoing lawsuit, from which Coke was dropped as a defendant by the judge in 2003. (The bottlers remain defendants.)

Activist Rogers is demanding that Coke pay reparations to the families of slain and displaced Colombian workers, noting that the company came up with \$192.5 million to settle a racial-discrimination class action in the U.S. in 2002. In Bogotá, SINALTRAINAL's Paez says each survivor should get regular payments equal to the monthly salary received by Coke's CEO. “What is a life worth?” he asks. A Coke spokesman responds: “We were not complicit in what happened, so it wouldn't make sense for us to pay reparations.” But Coke, resolving the legal questions by diffusing the Colombia controversy between two different things. ■

—With Elizabeth Woyke in New York

BusinessWeek online For more on labor conditions in Colombia, including a slide show and a closer look at how NYU made its decision, go to businessweek.com/extras

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ON LOO
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niche?

Bulgarian Back Lot, Hollywood Dreams

Sofia's Boyana Film Studios is being courted by Tinseltown player Nu Image—but a sale is complicated business

BY JACK EWING

STRAY DOGS DRINKING from puddles are the only sign of life on a rainy day at Boyana Film Studios in Sofia, Bulgaria. Rotting cabbages and potatoes, left from an Italian TV shoot, lie scattered on a street built to look like Boston's North End. A Roman coliseum awaits a new sword-and-sandal epic.

No, there's not a palm tree in sight, but this Communist-era studio could become the Balkans' answer to Burbank. Los An-

geles film producer Nu Image Inc., which has made 47 movies in Bulgaria since 1999, wants to buy Boyana and use it to vault beyond its action-flick niche and into films with Oscar potential. "I'm going to turn Boyana into one of the most important studios in Europe," says David Varod, a set-designer-turned-producer who is Nu Image's man in Bulgaria.

Varod's vow is not just show-biz bluster. Currently, Nu Image Bulgaria operates from a building that once housed an indoor swimming pool in Sofia, where it has built a thriving business churning out lowbrow

titles such as *Today You Die* and *Road Sharks*. But last year, Nu Image achieved what Varod hopes will be a breakthrough when it shot director Brian De Palma's best thriller, *The Black Dahlia*, on an L.A. street. Boyana, set on 74 acres just side Sofia, would give Nu Image a platform launching pad for its ambitions to produce more such prestige work.

Eastern Europe is already a filmmaker hot spot. Studios such as Prague's Barrandov, the setting for some of Walt Disney Co.'s current hit *The Chronicles of Narnia*, have a reputation for skilled technical

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at relatively low cost. But Bulgaria is even cheaper. Varod estimates that costs are 50% to 60% below those of Hollywood. Besides, "Boyana is up there with the iconic film studios. It's a great brand," says Patrick Newman, a consultant who represents London's Ealing Studios,

ch covets Boyana, too. Some Boyana equipment is out of date, but its facilities hide gems such as a soundproof orchestral recording studio that would be prohibitively expensive to build from scratch. It has an arsenal of medieval weapons. Buying Boyana would seem like a simple decision. But Nu Image's purchase of studio has turned into a cautionary tale of how complicated business can still be for Westerners who covet prime assets in Eastern Europe. On paper, Nu Image already won a competitive bid for Boyana in August with a bargain-basement price of \$7.4 million. But Bulgarian filmmaking—known for wrenching dramas that net film festival awards but not much money—are balking at the idea that Boyana may go to the maker of *Crocodile 2: Death Swamp*. That has given rise to a nasty battle. U.S. diplomats are pressuring the Bulgarians to honor its deal with Nu Image, arguing that the controversy is a test case of whether Bulgaria, which is due to join the European Union as early as next year, shows adequate respect for business agreements. British diplomats, meanwhile, are plugging for Ealing.

VS. COMMERCE

IN FACT, SOMEBODY should option the whole story. The cast includes Bulgarian Culture Minister Stefan Danailov, an actor who in his youth was known as the Bulgarian version of 1960s French heartthrob Alain Delon. Aside from dozens of films, Danailov appeared in a 2002 movie-made thriller called *Crisis in the Kremlin*, where he uttered such lines as: "I want you to kill Gorbachev." Now, Danailov, 63, is playing the heavy in the Boyana drama, blocking the privatization approved by a previous government. Danailov declined a request for an interview, but said in a statement that the deal contains "unacceptable peculiarities." Finally, the decision is back in the hands of Bulgaria's Privatization Agency, which could either approve the deal or reject the bidding process.

At its core, the Boyana saga is a classic

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le of art vs. commerce. Nu Image's
od, looking Hollywood-casual in fad-
eans, his gray hair tied in a ponytail,
an earring in his left ear, makes no
nd claims about Nu Image's *oeuvre*.
ion movies are part of the culture,"

the Israeli-born Varod, who saw
bat in both the
Day and Yom Kip-
wars but says he
onally opposes vice.
Whatever their
tic merit, Nu Im-
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the Sci-Fi Chan-
and others.

s the local talent
grows, other film-
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ing in. "Bulgaria is
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t Coulter, manager
Worldwide FX.
Nby, a Bulgarian at
orkstation digitally
eches the forehead
of n actor in *Lonely*
Harts, a new John Tra-
ca film.

u Image's status is
ing as well. As a
ried photo on the
va of Varod with ac-
rs Scarlett Johans-
o attests, the compa-
ys starting to work
v more A-list talent.
n addition to *The*
Black Dahlia, which

ts Johansson and Hilary Swank, Nu
nge Bulgaria last year shot *The Contract*,
euring Morgan Freeman and John Cu-
e. Upcoming films include a Johansson
irect in which she plays an English-
man who befriends Napoleon in exile.

IMPLACABLE CRITIC

MOD PROMISES to support Bulgarian
ima, too. But so many privatization
les have gone sour, with investors
topping assets rather than creating
o, that Bulgarians don't believe him.
ics charge, for example, that foreign
niemakers simply want to make a
ding by subdividing Boyana's real es-
a. In fact, Boyana is not far from ski-
les in an area already dotted with

gaudy mansions where tough-looking
security guards prowl the driveways.
Varod has agreed not to sell Boyana's
land for 20 years, but this hasn't satisfied
critics. "The only thing they haven't said
yet—and maybe it's still coming—is that
my mother's a hooker," Varod says.

Evgeny S. Michailov,
Boyana's chairman
and a respected Bul-
garian director, hasn't
questioned the honor
of Varod's mother, but
he is an implacable
critic. For the past
decade, Michailov, 51,
has tried to revive Boy-

THE BLACK DAHLIA
De Palma made the
Scarlett Johansson
pic in Bulgaria



Exit Stage East

Filmmakers flock to Bulgaria for
production cost savings of 50% or
higher. One example:

SOUNDSTAGE RENTAL PRICES

BULGARIA	U.S.
\$3.77*	\$16.50

* Typical weekly rate per square meter of space
Data: Ealing Studios, FilmL.A., Inc.

What should be the image of Bulgarian
film? Michailov leads a visitor through
Boyana's main studio building, built in the
'50s. Applause sounds from behind one
door—the audience at a Bulgarian version
of *Who Wants to Be a Millionaire*. That's
probably not what Michailov has in mind.
Then he opens a door to find Krassimir
Kroumov, a well-known director, at a con-
sole mixing a soundtrack for his latest
opus. On the screen, an old man holds out
a picture of a pretty girl and presses his
face against a rock, weeping. Two people
in a car look on impassively. Kroumov,
who speaks only a little English, tries to ex-
plain the plot but gives up. "It's complicat-
ed," he says. As Nu Image has discovered,
so is Bulgaria. ■



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MATH

{ will rock your world }

A generation ago, quants turned finance upside down. Now they're mapping out ad campaigns and building new businesses from mountains of personal data **BY STEPHEN BAKER**

NEAL GOLDMAN IS A MATH ENTREPRENEUR. HE WORKS ON Wall Street, where numbers rule. But he's focusing his analytic tools on a different realm altogether: the world of words.

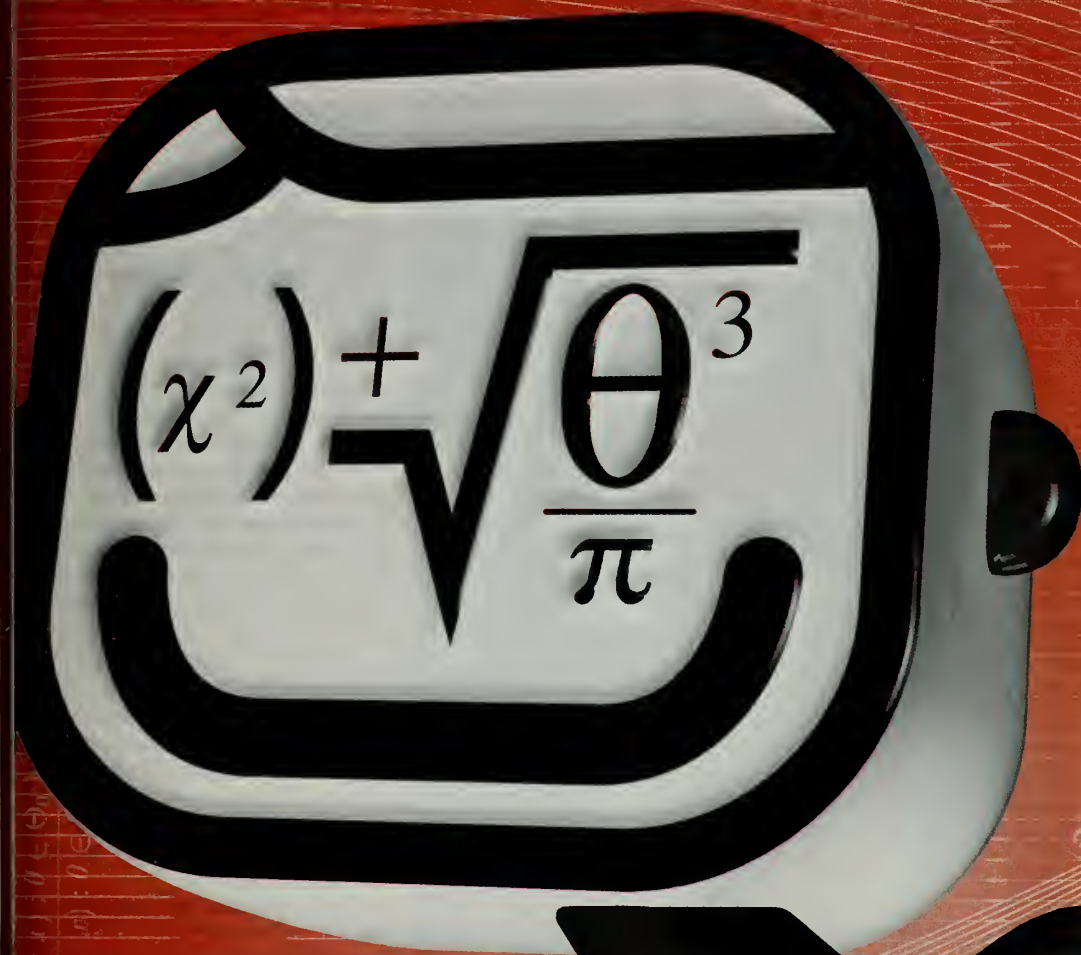
Goldman's startup, Inform Technologies LLC, is a robotic librarian. Every day it combs through thousands of press articles and blog posts in English. It reads them and groups them with related pieces. Inform doesn't do this work alphabetically or by keywords. It uses algorithms to analyze each article by its language and context. It then sends customized news feeds to its users, who also exist in Inform's system as—you guessed it—math.

How do you convert written words into math? Goldman says it takes a combination of algebra and geometry. Imagine an object floating in space that has an edge for every known scrap of information. It's called a polytope and it has near-infinite dimensions, almost impossible to conjure up in our earthbound minds. It contains every topic written about in the press. And every article that Inform processes becomes a single line within it. Each line has a series of relationships. A single article on Bordeaux wine, for example, turns up in the polytope near France, agriculture, wine, even alcoholism. In each case, Inform's algorithm calculates the relevance of one article to the next by measuring the angle between the two lines.

By the time you're reading these words, this very article exist as a line in Goldman's polytope. And that raises a fundamental question: If long articles full of twists and turns are reduced to a mathematical essence, what's next? Our businesses—and, yes, ourselves.

The world is moving into a new age of numbers. Partnerships between mathematicians and computer scientists are bulldozing into whole new domains of business and imposing efficiencies of math. This has happened before. In past decades, the marriage of higher math and computer modeling transformed science and engineering. Quants turned finance upside down a generation ago. And data miners plucked up nuggets from vast consumer and business databases. But look at where the mathematicians are now. They're helping map out advertising campaigns, they're changing the nature of research in newsrooms and in biology labs, and they're enabling marketers to forge new one-on-one relationships with customers. As this occurs, more of the economy falls into the realm of numbers. Says James R. Schatz, chief of the mathematics research group at the National Security Agency: "It has never been a better time to be a mathematician."

From fledglings like Inform to tech powerhouses such as IBM, companies are hitching mathematics to business in





that would have seemed fanciful even a few years ago. In the past decade, a sizable chunk of humanity has moved its work, play, chat, and shopping online. We feed networks gobs of digital data that once would have languished on scraps of paper—or vanished as forgotten conversations. These slices of our lives now sit in databases, many of them in the public domain. From a business point of view, they're just begging to be analyzed. But even with the most powerful computers and abundant, cheap storage, companies can't sort out their swelling oceans of data, much less build businesses on them, without enlisting skilled mathematicians and computer scientists.

The rise of mathematics is heating up the job market for luminary quants, especially at the Internet powerhouses where new math grads land with six-figure salaries and rich stock deals. Tom Leighton, an entrepreneur and applied math professor at Massachusetts Institute of Technology, says: "All of my students have standing offers at Yahoo! and Google." Top mathematicians are becoming a new global elite. It's a force of barely 5,000, by some guesstimates, but every bit as powerful as the armies of Harvard University MBAs who shook up corner suites a generation ago.

Math entrepreneurs, meanwhile, are raking in bonanzas. Fifteen months ago, Neal Goldman of Inform sold his previous math-based startup, a financial analysis company called Capi-

talIQ, for \$225 million to Standard Poor's (like *BusinessWeek*, a division of The McGraw-Hill Companies). And in May two brothers, Amit and Ba Singh, sold Perabit Networks—a company that developed algorithms for genetic research—to Juniper Networks for \$337 million.

In a world teeming with data, we ourselves become the math nerds' prized specimens. Researchers at Aetna Health Care, Amazon.com, and many other companies are piecing together mathematical models of customers, employees. Some models predict what music we'll buy, others figure out what worker is best equipped for a particular job. For now, these models are crude, digital equivalent of stick figures. Over the coming decade, each of us will give birth to far more fleshed out simulations of ourselves. We'll be modeled as workers, shoppers, voters, and patients. Some of the simulations will have names and credit cards attached, others a few genetic details. In others, identities will be shielded. Many of the models will be eerily accurate and others laughably off mark. But companies and governments will use them all the same to predict how to sell us things, steer clear of diseases, and ramp up our productivity. And yes, they'll try to use them to keep us from hijacking airplanes and detonating bombs.

This mathematical modeling of humanity promises to be one of the great undertakings of the 21st century. It will grow in scope to include much of the physical world as mathematicians put their hands on new flows of data, from atmospheric sensors to the feeds from millions of security cameras. It's a parallel world that's taking shape, a laboratory for innovation and discovery composed of numbers, vectors, and algorithms. "We turn the world of content into math, and we turn you into math," says Howard Kaushansky, CEO of Boulder (Colo.)-based Umbria, a company that uses math to analyze marketing trends on

The Dark Side

THIS INDUSTRIAL METAMORPHOSIS also has a dark side. The power of mathematicians to make sense of personal data and build a model of the behavior of individuals will inevitably continue to erode privacy. Merchants will be in a position to track many of our most intimate purchases, and employers will be able to rank us not only by productivity, but by wasted minutes. Worse, the rise of math can contribute to a sense that individuals are powerless, a foreboding that mathematics, from credit rating to our genomic map, spells out our destiny.

Debates over these issues have flared up many times in the past decade. And they are sure to rear up again as the U.S. Congress investigates the Bush Administration's mining of e-mail and Internet traffic in its effort to sniff out terrorists. Bu-



“Credit cards, bank accounts. Everything is being analysed 24/7 whether we like it or not. You would be amazed how much data is available.”

—Samer Takriti, IBM

ger of sophisticated data mining and higher math has tremendous power to conquer mankind's scourges as well. As Einhorn, chief technical officer of Inform, puts it: “The Jonas Salk will be a mathematician, not a doctor.”

he clearest example of math's disruptive power is in advertising. There Google and other search companies built on math turning an industry that grew on ideas, hunches, and personal relationships into a series of calculations. They can pull it because, quite simply, they know where their prospective customers are browsing, what they click on, and often, what they do. Internet companies use this data not only to profile customers but also to pitch for more contracts. Some 18 months ago, 30 blue-chip companies, from Procter & Gamble Co. to Walt Disney Co., underwent a series of tests promoted by the Interactive Advertising Bureau, an industry group. These studies matched consumer data to measure the effectiveness of advertising in a host of media. The results came back in hard num-

bers. They indicated, for example, that Ford Motor Co. could have sold an additional \$625 million worth of trucks if it had lifted its online ad budget from 2.5% to 6% of the total. Ford responded vigorously: Last August it announced plans to move up to 30% of its \$1 billion ad budget into media targeted to individual customers, half of it through online advertising. Such moves are sure to generate even more data, giving greater clout to the numbers people.

Just ask Imran Khan, the director of search advertising at E-Loan, an online lender. An accountant by training, Khan has turned the advertising operation into an enormous statistical laboratory. Like most others in the industry, he started three years ago by bidding on keywords on the major search engines. Over time, Khan's team has amassed a portfolio of 250,000 key words and phrases. Each time a Web surfer types one of those words in a search engine, an E-Loan ad appears next to the results, and Khan's team pays the price bid for each click. But running search-based ads is hardly a static process. Working with Efficient Frontier Inc., an analytics startup in Silicon Valley, Khan crunches his stash of words, calculating the return on investment for each one and tweaking thousands of bids hour by hour. He spends \$15 million a year—half of E-Loan's ad budget—and he accumulates massive feedback from customers.

As data mavens gather more information about customers, they gain muscle to demand changes inside companies. Take media. With banks of consumer data continuing to swell, quants on the marketing side will be able to provide editors and program managers with increasingly sophisticated statistical models, telling them which types of TV scenes or articles appeal most to certain demographic groups. As publishers seek to op-

How Math Transforms Industries

Mathematicians have long enjoyed celebrity status in Silicon Valley and on Wall Street. Now they're using their trade throughout the U.S. economy:

Consulting

MB: Big Blue is building math profiles of 50,000 consultants that computers can pick the perfect team for every assignment. Other tools eventually will be able to track their progress, hour by hour, and rate their performance. Workers will eventually labor in virtual assembly lines.

Food and Beverage

WOLOGIX: The goal of this California consultancy is to help partners mimic the chemistry of wines ranked highly by leading critic Robert B. Parker. It employs algorithms to cull a database of 70,000 vintages and run the analyses. Precise studies of customer data provide blueprints for new products.

Advertising

EFFICIENT FRONTIER: The Silicon Valley startup provides mathematical optimization for online ad campaigns. It calculates response rates and return on investment for every advertisement. Broad shift from hunch-based campaigns to mathematical targeting.

Police and Intelligence

NATIONAL SECURITY AGENCY: Mathematicians at nation's top techno-spy agency build algorithms to trawl Internet and phone traffic looking for patterns in speech, subject, and frequency that might point to the next attack. Investigators wade through rivers of data in search of would-be terrorists.

Marketing

UMBRIA: Colorado startup assigns numeric values to picks and pans of products that pop up on blogs. Using vector graphics, it confirmed that raunchy Burger King ads online turned off nearly everyone, except for the target audience of young men. Math-based consultancies scour blogs and podcasts for market intelligence.

Media

INFORM: This New York startup turns written articles into bits of geometry and organizes them in a virtual library. It can match the articles to readers' math-based profiles. Automatic systems threaten to supplant editors.

timize profits and performance, data analysis will grow in importance. The risk: It gives math-based analysts, not to mention advertisers, a growing role in editorial decisions. "It puts a question mark around the classic church-state divide in the media," says Rex Briggs, founder of Marketing Evolution, the San Francisco company that conducted the 30 advertising studies.

Rising flows of data give companies the intelligence to home in on the individual customer. Internet marketers are the natural leaders, but traditional businesses are following suit. Gary W. Loveman, CEO of casino giant Harrah's Entertainment Inc. and a former Harvard B-school professor, has led the company to build individual profiles of millions of Harrah's customers. The models include gamblers' ages, gender, and Zip codes, as well as the amount of time they spent gambling and how much they won or lost. These data enable Harrah's to study gambling through a host of variables and to target individuals with offers, from getaway weekends to gourmet dining, calculated to maximize returns. In the last five years, Harrah's has averaged 22% annual growth, and its stock has nearly tripled.

Pi in the Sky

MATH IS ALSO POSITIONED to shake up investigations. Whether in law, journalism, or criminal detective work, sleuths have relied for centuries on the human brain to pick through strands of disparate evidence and to find patterns. Sherlock Holmes sometimes looked for them in plumes of pipe smoke. And why not? Even today, no machine could sift through the photos, names, words, geographical coordinates, snippets of video—that towering mountain of information that computer scientists call "unstructured data."

But some companies are making inroads. Colorado's Umbria has built a system to sift through millions of blogs in real time, looking for market intelligence. Umbria breaks down English messages into the smallest components—words,



6
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phrases, grammar, even errors—and turns them into math. Then it analyzes the content, looking for trends. It can give cell-phone companies fast-food restaurants the late buzz on an ad campaign or a new sandwich.

Sometimes it uncovers trends researchers were even looking for. A recent search for Gatorade, for example, showed that large numbers of young men look to it as a cocktail mixer in hopes that electrolytes in the sports drink will ease hangovers. In the future, similar insights could uncover countless other patterns. They could help bankers screen entrepreneurs careening toward bankruptcy or point

lice toward sociopaths planning terrorist acts.

At the Sunnyvale (Calif.) campus of Yahoo, chief research Prabhakar Raghavan heads a team of 100 mathematicians and computer scientists. Scribbling on a white board covered with equations, Raghavan describes Yahoo's immense pool of data featuring the online activity of 200 million registered customers, as Yahoo's most precious resource. There is a whole world of uninvited businesses, he believes. They'll come being as Yahoo discovers new ways to satisfy the urges, curiosities, and desires of this customer base. The hints of the future businesses float in the oceans of Yahoo's data. Raghavan's mandate is to sift through that data and form new connections among consumers, e-marketers, and advertisers. After algorithms, he says, "are critical to survival."

As companies continue to receive ever more data about their own processes and their workers, many will use math to boost productivity and shake up the workplace. This doesn't have to be limited to one company. Vast globe-spanning projects can be modeled, then cut into tiny pieces, with each task going to the best-qualified person. Pierre Haren, CEO of Paris-based ILC company that turns customers' raw data into visual displays foresees virtual assembly lines. "We'll have systems that tap knowledge by the minute," he says. "Productivity could rise a factor of 10."

That may sound like more digital pi in the sky. It's actually an extension of mathematical modeling that's been going on for a century at companies like IBM. Following World War II, researchers at Big Blue constructed a mathematical model of the company's supply chain. It featured raw materials, trucking schedules, and manufacturing plants. Once the company had a working model, it put it through a mathematical analysis called optimization. The results suggested specific improvements, and the engineering sped up IBM's operations and cut costs. Decades later, IBM turned optimization into a leg of its services business. Today, consultants are implementing math-based blueprints to upgrade steel mills in China, revamp operations at the U.S. Postal Service. If you look back at those old supply-



"The flow of data is growing faster than the processing power to crunch it. To

winnow it down, we must come up with exponentially better algorithms."

—Prabhakar Raghavan, Yahoo!

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How Much Math Do We Need to Know?

Recommendations vary, depending on your profession, your goals, and your stage in life. Some pointers:

»Calculus:

This remains the gateway discipline for all of engineering and science, plus finance. B-school grads with strong calculus find far more opportunities.

Career Tip: To sidestep calculus is to slam shut doors to growing realms in the 21st-century job market, including many of the most lucrative.

»Statistics and Probability

Standard in social sciences, they will become core skills for businesspeople and consumers as we grapple with challenges involving large data sets. Winners will know how to use statistics—and how to spot when others are dissembling.

Career Tip: They'll come in handy whether you're building financial models at Goldman Sachs or marketing plans at Ford. (Parents take note: Children who really understand probability won't squander savings on state lotteries.)

programs, there's one important element nearly absent: the human being. People were represented by numbers and were largely interchangeable. The mathematicians' systems lacked the data to provide more detail. And even if they had amassed a huge pile of it, the primitive computers of the time would have choked on it.

Now, though, at an IBM research center a half-hour's drive north of New York City, a 40-member team of researchers is scrutinizing people. The team combines data miners, statisticians, and experts in operations research. The current project is to refocus the supply-chain programs on 50,000 of the consultants in IBM's services division. That means that instead of modeling machines, furnaces, and schedules, they're building models of their colleagues.

A leader in this effort is Syrian-born Samer Takriti, who came from the math shop at Enron Corp. Years before the accounting mess brought the company down, Enron pioneered advanced math to create new financial markets. IBM hired Takriti for a second stint in 2000, a year before Enron's collapse. Big Blue named him senior manager of stochastic analysis. That's the science of incorporating random behavior, including the meanderings of humans, into math models.

The first step in modeling IBM's workforce, says Takriti, is to harvest all sorts of data from company records. To date, these

»Algebra and Geometry

Key stepping stones to calculus. Mathematicians say that algebra is central to problem solving and that geometry's proofs and theorems prepare for the rigors ahead.

Career Tip: You may associate geometry with floor tiling, but is one of the hottest fields in math today. Advanced geometry is key to designing search engines, including Google's. But the geometry used at this level comes after calculus.

»Math Tools

Though disdained by many mathematicians, Microsoft Excel is a vital tool for generalists. Those who master it and some add-in whether in advertising or law, can produce statistical analysis and reports that their unschooled colleagues can't touch.

Career Tip: Many workers coming out of college and grad school already master Excel. It's midcareer workers who really need the training.

professionals are divided into 200 categories. But the n team is hunting for richer personal details. A survey of con ny e-mail, Takriti says, could highlight communication links tween employees and the informal social networks that create. Workers who e-mail each other a lot are more like work well together. Calendar data could show which con ants have more free time. Eventually, by tracking mobile vices, the system will know exactly where the consultants And when a contract comes through for, say, a new call ce in Manila, IBM's optimization program will cull through a global database and put together the perfect team.

Calculus Ahead

THE PROGRAM will take years to implement. "People complicated," says Takriti. "If you have a system, they f out how to game it. Machines never do." This means th searchers will have to factor in a certain amount of hu behavior, from lowballing sales targets to "accidentally" c ing a rival's snazzy report. This threatens to make the m fuzzier. Still, if IBM's operation yields fruit, you can bet Big Blue will be offering similar workforce modeling ser to its customers.

Eventually IBM-like programs will reach us. And it do take much imagination to see where that can lead. Man will operate tools not only to monitor employees' perform but also to follow their movements and drive up produc Perhaps, like Internet marketers, they'll even have the to link these initiatives to revenue or return on investment. C other side, consumers will be armed with ever more data, predictive models of real estate markets to patient mo charts for comparing different oncologists.

It adds up to an era chock-full of numbers. Outfittin dents with the right quantitative skills is a crucial test f school boards and education ministries worldwide. This pecially true in America. The U.S. has long leaned on forei to provide math talent in universities and corporate res labs. Even in the post-September 11 world, where it is harc

Behind the Numbers

Get the Story on the Cover Story: For a podcast interview with Senior Writer Stephen Baker by Executive Editor John A. Byrne, go to www.businessweek.com/search/podcasting.htm

Word Power: How Imran Khan, chief of search advertising at E-Loan, has turned the operation into a statistical laboratory

The New Math at the Top Spy Shop The National Security Agency waged math war with the Russians for a half-century. But now it must battle the likes of Google and Yahoo! for the best math brains.



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foreigners to get student visas, an estimated half of the 20,000 math grad students now in the U.S. are foreign-born. A similar pattern holds for many other math-based professions, from computer science to engineering.

The challenge facing the U.S. now is twofold. On one hand, the country must breed more top-notch mathematicians at home, especially as foreigners find greater opportunities abroad. This will require revamping education, engaging more girls and ethnic minorities in math, and boosting the number of students who make it through calculus, the gateway for math-based disciplines. "It's critical to the future of our technological society," says Michael Sipser, head of the mathematics department at Massachusetts Institute of Technology. At the same time, school districts must cultivate greater math savvy among the broader population to prepare it for a business world in which numbers will pop up continuously. This may well involve extending the math curriculum to include more applied subjects such as statistics (table, page 60).

Private Lives

ONE SIGNIFICANT challenge to the math revolution is to build new businesses from data without sacrificing privacy. If customers, patients, and workers have reason to fear that the intimate details of their lives are floating around in databases, they'll likely work to lock up their information or move it off network. This could disrupt efforts to use math and data mining to fight disease and to battle terrorism. The goal now is to create systems that share group information while shielding the individual. This way, researchers working with a database of HIV or breast cancer patients, for example, could study them by age, race, income, medication, education, and neighborhood without zeroing in on one person.

Mathematicians are at the heart of the privacy battle—on both sides. In Microsoft Corp.'s laboratories near San Francisco, Cynthia Dwork, a cryptographer, is working on a system to

shield individuals while making use of the data. Dwork and her team are encasing each person's records in a camouflage of numbers that she calls "noise." Think of looking at a picture of a crowd. As soon as you zoom in on an individual face, it comes pixelated. It's a promising approach, but even Dwork admits that mathematically gifted hackers can continue to open doors that she and her team slam shut. "As cryptographers, we know the power of the adversary," she says.

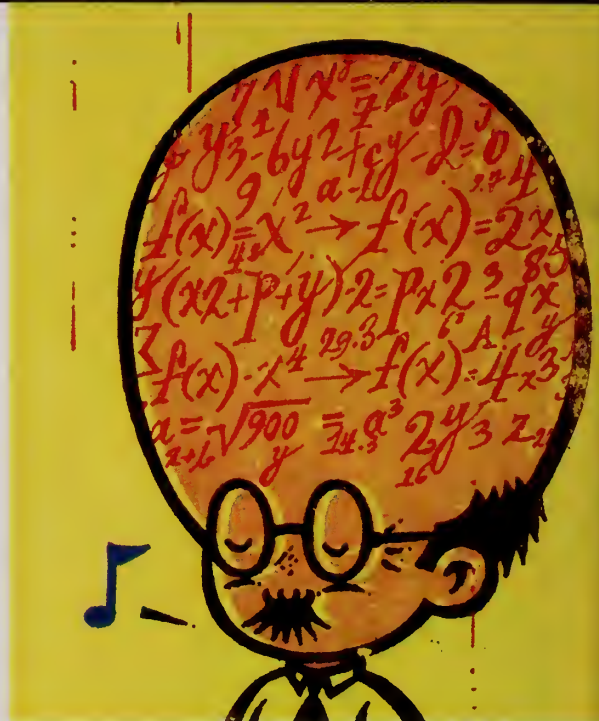
Math's other problem? Sometimes it's just not as smart as advertised. As mathematicians expand their domain into the humanities, they're working with new data, much of it untested. "It's very possible for people to misplace faith in numbers,"

Craig Silverstein, director of technology at Google. The antidote at Google and elsewhere is to put mathematicians on teams with specialists from other disciplines, including the social sciences.

Just as mathematicians need to grapple with human quirks and mysteries, managers and entrepreneurs must bone up on mathematics. Midcareer managers delegate much of this work to staffers. But they still must understand enough about math to question the assumptions behind the numbers. "No one's easier for people to bamboozle someone having analysis based on lots of data graphs," says Paul C. Pfeleiderer, a finance professor at the Stanford Graduate School of Business. "We have to train people in business to spot a bogus argument."

And to spot opportunities. As more of the world's information is pooled into mathematics, the realm of numbers becomes an ever larger meeting ground. It's a promising laboratory full of surprising connections and a birthplace for new industries. Yet it's a magnificent time to know math. ■

—With Bremen Leak in New



The NSA: Security In numbers

THE JOB OFFERS ARRIVED in plain envelopes. For decades, the mathematicians who accepted them stole off to Washington and the hush-hush National Security Agency, the nation's top techno-spy agency. Through the Cold War, NSA math whizzes matched wits with the Soviets: Each side protected its own secret codes while trying to break the other's.

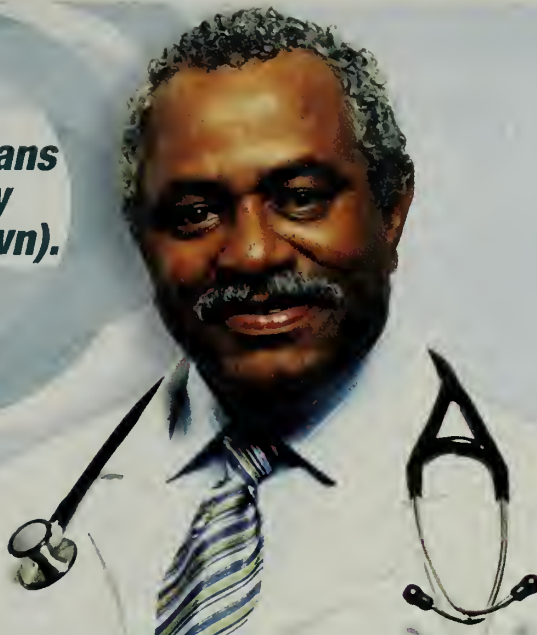
Math is more important than ever at the NSA. Chances are, the world's growing rivers of data contain terrorist secrets, and it's up to the agency's math teams to find them. But to land the best brains, the NSA must compete with free-spending Web giants such as Google and Yahoo! This is leading the agency to open up its recruiting process. "We have to look at new and innovative ways to find talent," says Cynthia Miller-Wentt, chief of the NSA's recruitment office. The agency is even sponsoring math contests....

BusinessWeek online

For the rest of the story on math at the NSA, go to www.businessweek.com/extras

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LIPITOR® (atorvastatin calcium) is a prescription drug. It is used in patients with multiple risk factors for heart disease such as family history, high blood pressure, age 55 or older, low HDL or smoking to reduce the risk of heart attack and stroke and, along with a low-fat diet, to lower cholesterol.

It is also used in patients with type 2 diabetes and at least one other risk factor for heart disease such as high blood pressure, smoking or complications of diabetes, including eye disease and protein in urine, to reduce the risk of heart attack and stroke.

LIPITOR is not for everyone. It is not for those with liver problems. And it is not for women who are nursing, pregnant or may become pregnant.

If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of serious muscle side effects. Tell your doctor about all the medicines you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose. The most common side effects are gas, constipation, stomach pain and heartburn. They tend to be mild and often go away.

Please see additional important information on next page.

LIPITOR is one of many cholesterol-lowering treatment options in addition to diet and exercise that you and your doctor can consider.

*Results are based on a subset of a blinded, national, random survey of 694 physicians representative of the AMA master file, conducted by Harris Interactive Inc. from April 25, 2005 through June 17, 2005.

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IMPORTANT FACTS



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LOWERING YOUR HIGH CHOLESTEROL

High cholesterol is more than just a number, it's a risk factor that should not be ignored. If your doctor said you have high cholesterol, you may be at an increased risk for heart attack. But the good news is, you can take steps to lower your cholesterol.

With the help of your doctor and a cholesterol-lowering medicine like LIPITOR, along with diet and exercise, you could be on your way to lowering your cholesterol. Ready to start eating right and exercising more? Talk to your doctor and visit the American Heart Association at www.americanheart.org.

WHO IS LIPITOR FOR?

Who can take LIPITOR:

- People who cannot lower their cholesterol enough with diet and exercise
- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

BEFORE YOU START LIPITOR

Tell your doctor:

- About all medications you take, including prescriptions, over-the-counter medications, vitamins, and herbal supplements
- If you have muscle aches or weakness
- If you drink more than 2 alcoholic drinks a day
- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C). In adults, it can lower the risk of heart attack in patients with multiple risk factors for heart disease—such as family history of heart disease, high blood pressure, older than 55, low "good" cholesterol, or smoking.

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
 - **Liver problems.** Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.
- Symptoms of muscle or liver problems include:
- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
 - Nausea, vomiting, or stomach pain
 - Brown or dark-colored urine
 - Feeling more tired than usual
 - Your skin and the whites of your eyes turn yellow
 - If you have these symptoms, call your doctor right away.

The most common side effects of LIPITOR are:

- Headache
- Constipation
- Diarrhea, gas
- Upset stomach and stomach pain
- Rash
- Muscle and joint pain

Side effects are usually mild and may go away by themselves. Fewer than 3 people out of 100 stopped taking LIPITOR because of side effects.

HOW TO TAKE LIPITOR

Do:

- Take LIPITOR as prescribed by your doctor.
- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

- Do not change or stop your dose before talking to your doctor.
- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
- Do not break the tablet.

NEED MORE INFORMATION?

- Ask your doctor or health care provider.
- Talk to your pharmacist.
- Go to www.lipitor.com or call 1-888-LIPITOR.





ELLISON In two years the CEO has spent \$19 billion buying rivals

The Hardest Job in Silicon Valley

Oracle has been snapping up companies. Now John Wookey has to meld them together and please his boss, Larry Ellison

BY SARAH LACY

IN THE WEE HOURS OF DEC. 28, John Wookey was awakened by fire alarms at Disneyland's Grand Californian Hotel. A six-story plastic Christmas tree had caught fire and, as smoke filled the air, Wookey and his wife bundled up their three kids and hustled them outside. They spent three hours huddled with other guests in a theater at the darkened theme park. Says Wookey: "We didn't know if the whole hotel was burning down."

Still, for Wookey this counted as relaxation. As Oracle Corp.'s senior vice-president in charge of applications, he has one of the toughest jobs in software. Over the past two years, Chief Executive Lawrence J. Ellison has spent \$19 billion buying up 14 rivals in the corporate software market. His buying binge included paying \$10 billion for PeopleSoft Inc. and \$5.8 billion for Siebel Systems Inc. That was the easy part. Putting it all together is Wookey's job. "My head is the one on the chopping block if this doesn't work," deadpans Wookey. He's mostly joking, but in the past Ellison has been quick to fire executives who don't perform.

The plan is to meld the best of what Oracle has bought into a new suite of software code-named "Project Fusion." The integrated package will help corporations run everything from accounting and sales to customer relations and supply-chain management. Ellison's hope is that Fusion—together with all the new customers he landed with his acquisitions—will finally give him the edge he needs to overtake the top corporate applications company, Germany's SAP.

STIFF COMPETITION

WHILE ANALYSTS applauded all of Ellison's purchases as they came along, they're now skeptical about Oracle's ability to execute on its strategy. Says John R. Rymer of research firm Forrester Research Inc.: "I'm not saying it's impossible, but it'll be really, really hard to be successful." Oracle's stock has slid 14% in the past two years and the price seems mired in the 12-to-14 range.

Meanwhile, SAP is flying high. It holds 21% of the corporate applications market, vs. Oracle's 11%. And on Jan. 10, SAP said that preliminary results for the fourth quarter show that software license revenues rose 18%, suggesting it's picking up more share. "SAP is becoming the standard for business software," says William McDermott, CEO of SAP Americas. "Oracle is in a state of chaos."

To get Oracle's market share growing,

Wookey must build a new suite of software applications—using the latest technology and drawing the best from each of the acquired companies. He has to persuade customers to wait for him to finish his task and then gradually switch more of their computing jobs to run on Oracle software. And he has to fend off SAP, which is attempting to take advantage of customers' uncertainty and pick them off.

The tech world will get its first indication of how well Wookey is doing on Jan. 18, when Oracle presents a progress report. Wookey plans to lay out the technical details of how Oracle is piecing together the components of Fusion—and then map out interim goals before the planned 2008 release of the entire suite of applications. One key message: Customers should go ahead and buy Oracle's existing middleware—software used to make diverse applications work together smoothly—because it already fits with the acquired applications and will be the foundation for the Fusion applications that are coming. "We're trying to leave people with the impression that they've made a good investment and we're doing a good job supporting them in that investment," Wookey says.

ARMANI OR MEN'S WEARHOUSE

THE GRAND VISION to take on SAP by fusing the best of the rest is all Ellison's. But while he's the mastermind, Wookey is the foreman. Wookey has worked at Oracle for a decade, earning his stripes as an executive in the customer relations and accounting groups. His career took off after he ran a pet project of Ellison's: building applications for the health-care industry. He was promoted a year ago to run the entire applications business.

The two men stand in stark contrast to each other. Ellison once quipped during an Oracle event as he was leaving the stage to Wookey that the Armani part of the program was ending and the Men's Wearhouse part was starting. While Ellison enjoys fast cars, fast boats, and fancy suits, Wookey is a devoted family man. He gets up at 4:15 a.m. every day for a jog and dog walk, works for several hours, then takes the kids to school. At work, while Ellison is brash and contentious, Wookey is a soft-spoken diplomat. He's known for his straight talk and dry wit.

That disarming style has made him the perfect goodwill ambassador to the customers Oracle has swallowed up through acquisitions during the past year. Since he took command of the Fusion project, he has crisscrossed the world making personal appeals to customers. To make sure



Software Fusion

Oracle spent about \$19 billion buying 14 companies in little more than a year. John Wookey (above) faces many challenges in making the parts work together:

COMPLETE THE INTEGRATION



It'll take a massive effort to pull together the best features from PeopleSoft, J.D. Edwards, Siebel Systems, and other acquisitions into one suite of software, rewritten to take advantage of the latest technological advancements. It won't be complete until 2008.

PLACATE CUSTOMERS



Oracle is still smarting from its 1990s reputation of strong-arming customers into buying too much software that was costly and time-consuming to install. Oracle needs to be more responsive if customers are going to wait around for Fusion.

WIN OVER WALL STREET



Oracle's stock has been slumping, down 8% in the past year. While many analysts think individual Oracle acquisitions make sense, there's big concern about whether the company can pull off such a massive integration.

TAKE THE FIGHT TO COMPETITORS



Oracle's goal is to surpass SAP as the largest business-applications company. But SAP has a sizable lead in market share, 21% to Oracle's 11%, and it's out ahead of Oracle in the race to incorporate recent tech advances.

he's on the right track with Fusion, he vets his plans with an advisory council of customers. SAP has lured away a few high-profile customers, such as Samsonite Corp., but most are holding firm, at least for now. "[Wookey] has given Oracle more credibility, and I'm willing to wait out the time frame," says John Matelski, deputy chief information officer for the

city of Orlando. But he adds a warning: "If 2008 rolls along and they are way behind, I'll have to rethink that strategy."

Within Oracle, Wookey's greatest strength is as a consensus builder. On Monday at midday, he presents progress reports to Ellison and Co-President Charles E. Phillips Jr. and Safra A. C. After that, he meets with his 14 senior staff members to hash out nitty-gritty product details. There's vigorous debate over how the applications should be built and what features are most important. The Oracle of old might have been polarized, but Wookey keeps things moving.

MR. NICE GUY

TYPICAL OF WOOKEY'S style was a 1-hour meeting with his top staff on Jan. 18. Looking around the conference room was hard to tell who was in charge. Wookey didn't sit at the head of the table, and he let others do most of the talking. As developers argued over arcane technical matters, Wookey weighed in to resolve debates—often by reminding them of what customers had asked for.

One of Wookey's most notable virtues was holding on to the software engineers who came to Oracle from acquisitions. So far, nearly all of the developers whom Oracle offered jobs are still at the company. "I had an image of everyone [at Oracle] had been grown boys," says John Schiff, a former PeopleSoft manager. "But John pressed the importance of family values, and you see it in his own behavior and just very comfortable."

While the technical challenges are daunting, Oracle has potent weapons. The leader in the database software market, with a 30% share to IBM's 26%, it has been gaining ground rapidly in middleware. Oracle is the only one of the three: database, middleware, and applications. That's important because customers prefer software packages that are tuned to work well together, and Oracle does that.

Timing is key. SAP has its own middleware, called NetWeaver. It's further along in modernizing its applications with the latest technologies. And it doesn't face as many awesome technical challenges that Oracle does in melding all those applications from different companies.

If Wookey can meet his deadline and take full advantage of Oracle's software franchises, he'll have a fighting chance in the battle between the tech titans. If not, he might find himself on another vacation. Only the next one will be permanent. ■



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BY PETE ENGARDIO

TAKE A CAB RIDE THROUGH BOMBAY, AND THESE ARE THE SCENES that will likely strike you first: raggedly dressed homeless families sprawled on blankets amid shacks. Traffic hopelessly clogged with every manner of soot-belching vehicle and wooden cart. Gaunt hawkers and beggars tapping on your window at red lights. For foreign visitors, such jarring images of poverty and desperation are hard to shake. ¶ View those same streets through the eyes of C.K. Prahalad, however, and they become a beehive of entrepreneurialism and creativity. "I see the positives inside the muck," says Prahalad as he settles his stocky frame into the back of a hired Tata Indica sedan to conduct a quick tour of Bombay. As the car crawls through congested Mohamed Ali Road, he notes that virtually every individual is engaged in a business of some kind—whether it is selling single cloves of garlic, squeezing sugar cane juice for pennies a glass, or hauling TVs.

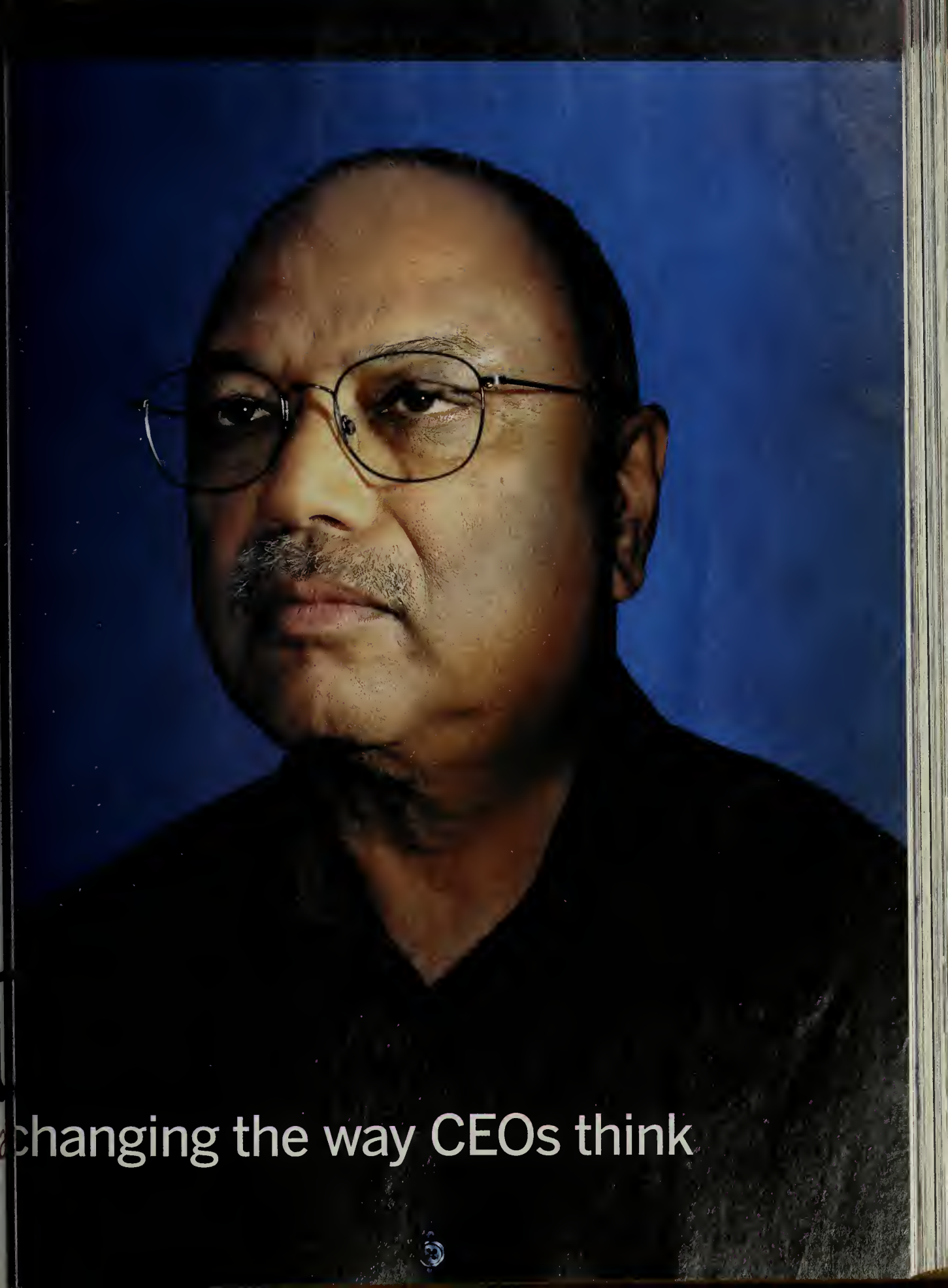
On every block he points out the intriguing enterprises tucked into the nooks and crannies. With the world's cheapest telecom rates, "all you need here is a phone and a \$20 card to start a business," he explains in his measured baritone. He notices a busy closet-sized shop charging a few pennies per page to send faxes. "That guy probably started with a single phone and then added a fax and printer. Now he has a self-contained communications center offering extremely low prices." Such entrepreneurs, he contends, pioneered cheap pay-per-use services long before they became a fad in the West. The car stops at a small dry-goods shop. Prahalad bounds out and asks the owner to let him behind the counter. Tiny 5¢ single-serve containers of shampoo, soap, toothpaste, and other household goods dangle from the walls and ceiling. He notes the brands: Head & Shoulders, Lifebuoy, Pears, Colgate, Lux. "Low quality won't sell," he says.

By the end of an hour it's hard to look at Bombay and its impoverished citizens in the same way. That's exactly what Prahalad, 64, intended. The University of Michigan professor's knack for being able to change people's perceptions of the world around them has made Prahalad an incredibly influential corporate strategist. He has built a lucrative consulting career helping such multinationals as Citibank, Philips, and Philip Morris break out of ingrained mind-sets and craft new business models. Prahalad and colleague Gary Hamel helped spark a management revolution in the 1990s with their idea of "core competence," which says that companies must identify and focus on their competitive strengths. Their 1994 book, *Competing for the Future*, is regarded as a classic. A decade later he co-wrote *The Future of Competition*, which argued that the traditional "company-centric" approach to product innovation is giving way to a world in which companies "co-create" products with consumers. That book gave Prahalad a reputa-

DAN WINTERS

Business Prophet

How C.K. Prahalad

A close-up portrait of a middle-aged man with dark hair, a mustache, and glasses. He is looking slightly to the left of the camera with a serious expression. He is wearing a dark, possibly black, button-down shirt. The background is a solid, deep blue. The lighting is soft, coming from the front and slightly to the side, highlighting his facial features.

changing the way CEOs think

tion among designers. At the same time, he has been working to convince executives that today's needy masses, so often dismissed as subsisting largely outside of the global economy, are actually its future. Prahalad's 2004 work on that topic, *The Fortune at the Bottom of the Pyramid*, has been hailed as one of the most important business books in recent years and turned Prahalad into a celebrity in the field of international development.

Street-smart innovation

NOW ONE OF THE MANAGEMENT world's most creative thinkers has an even more radical idea: He believes that the entrepreneurial ingenuity at work amid such poverty, where success depends on squeezing the most out of minimal resources to furnish quality products at rock-bottom prices, has cosmic implications for executives and consumers everywhere. Some of the most interesting companies of the future won't emerge from Silicon Valley or other places of abundant means, he says. They will come from places many executives don't even think about because they have been considered too marginal. They won't have that excuse for much longer, though.

In the world according to C.K.—short for Coimbatore Krishnarao—poor nations are incubating new business models and innovative uses of technology that in the coming decade will begin to transform the competitive landscape of entire global industries, from financial and telecom services to health care and carmaking. Globalization, outsourcing, the Internet, and the spread of cheap wireless telecom are accelerating dramatic change. Few Western corporations fully harness these forces, Prahalad warns. And that puts them in danger of being usurped by a new breed of supercompetitive multinationals completely off their radar, just as American industrial icons such as Xerox, General Motors, and RCA were blindsided in the '70s and '80s by nimbler Japanese upstarts including Canon, Toyota, and Sony.

For his next book, due in fall, 2006, Prahalad is assembling case studies of Indian companies that could spawn entirely new ways to think about conducting business. Fast-growing telecom operators such as Bharti, Reliance, and Tata, for example, are profitably selling cellular service for as little as 2¢ a minute “even though they must buy the same hardware as Western companies,” he says. Now they're preparing to launch broadband TV, data, and voice for around \$30 a month—about a third of the cost of such packages in the U.S. Bangalore's

Narayana Hrudayalaya hospital charges a flat fee of only \$1,500 for heart bypass surgery that would cost 50 times that in the U.S. and operates on hundreds of infants each year for free. Yet it is highly profitable, has no debt, and claims a higher success rate than most U.S. hospitals. Narayana also profitably insures 2.5 million poor Indians against serious illness for 11¢ a month per person.

Low wages alone can't account for such price gaps with the West, Prahalad contends. The real secret is ingenious cost-cutting practices, such as extreme reliance on outsourcing, novel use of technology, and making the most of capital investment. “These are radical innovations,” Prahalad says, many which can be adapted to the U.S. Just look at the info tech industry: Long dominated by giants IBM, EDS, and Accenture, it has already been transformed by Indian companies such as Infosys and Wipro that supply top-quality services at lower prices. That, says Prahalad, is just the beginning of the revolution.

How seriously should we take Prahalad? His theories rarely draw skeptics. For instance, bottom-of-the-pyramid economics don't always help the bottom line, notes Microsoft Corp. Technology Officer Craig J. Mundie. Prahalad's work has forced Microsoft's view that it must develop software using different pricing, payment systems, and technologies in developing nations. “But even if you can execute a plan to sell to the poor, it's not clear you can make money,” Mundie says. “Many companies in many industries have struggled to make a go of it, frankly.” In response, Prahalad notes that many once argued that a \$500 PC was impossible. Now they cost as little as \$100.

Prahalad hasn't always had the Midas touch himself. A



One-Man Idea Lab

Few strategic thinkers have developed as many influential global management theories over the past two decades as C.K. Prahalad. Here are some of his best-known concepts:

Global-Local Balance

1976 As a Harvard doctoral student, Prahalad helped spawn a new field in multinational thinking by arguing that companies must continuously balance global integration and local responsiveness. The work culminated in the 1987 book *The Multinational Mission*, by Prahalad and Yves L. Doz.

Dominant Logic

1986 Execs make strategic decisions based on ingrained assumptions that often are out of date and inhibit innovation, wrote Prahalad and Richard A. Bettis in *Strategic Management Journal*. Many consultancies now help companies change “**mental models**” as part of business transformation.

Core Competence

1990 The idea that companies should focus on their accumulated knowledge and core competiveness remains a guiding management mantra a decade and a half down the road. Prahalad and Hamel coined the term “**core competence**” in what is now the most widely reprinted Harvard Business Review article ever.





SPECIALISTS At Narayana Hrudayalaya, surgeons do nothing but surgery

the first studies to argue that corporations need new structures to project global strategies while adapting to local needs. He also began nurturing concepts he would build on later in his

career: that entrepreneurs should not let limited resources constrain their ambitions or let deeply ingrained biases blind them to revolutionary change.

Prahalad's broad curiosity means his business insights tend to be fresh and ever-evolving. He consumes tomes on the rise and fall of nations, the spread of languages, and the history of such commodities as salt, tobacco, and cod. He is fascinated by historical maps and bird migratory patterns, which offer clues of the world's shifting ecology. Prahalad lives with Gayatri, his wife of 35 years, in a sprawling home in San Diego's posh Rancho Santa Fe district but spends about 40% of his time on the road. While traveling he does his own case studies of new business models and pumps everyone—cab drivers, factory workers, university kitchen staff—for insights. Ask him to tell a joke, though, and he's stumped. "I have to admit, I am not very fun at parties," he admits.

Prahalad built his following among CEOs as a blunt and demanding corporate adviser. Rather than operate with a retinue of junior staff, he likes to arrive alone with his Toshiba laptop, fully armed after doing his own analysis of the company's competitive strengths and weaknesses. He then proposes practical ways to correct management flaws. "The best way to describe C.K. is, he's an out-of-the-box guy who is pragmatic," says Hewlett-Packard Co. CEO Mark V. Hurd, who ran NCR Corp. until March. Prahalad has been on NCR's board since 1997. "It's quite an art to get a board filled with past and current CEOs to think of the world in a different way."

As a consultant, Prahalad begins by trying to force managers to shake free of their "dominant logic." The stunt Prahalad pulled with the top brass of Royal Philips Electronics in 1991 is legendary. The Dutch electronics conglomerate, losing market share fast in consumer appliances, hired Prahalad for a week-end brainstorming session. He started the Saturday morning meeting by reading a small item he said he had seen in the *Financial Times*. Philips was heading into bankruptcy, the article speculated, and bankers wanted to know management's game plan. "Forget what we are supposed to talk about. There is a major crisis," Prahalad warned. "You had better figure out what you are going to do about it." He broke the stunned executives

software firm he co-founded in 2000 struggled and was eventually sold. Of that experience, Prahalad said he at least gained some insight into his own management style. "I get extremely energized when there is an extremely complex problem solved," he says. "But management is a lot of blocking and tackling."

Solving insights

PRAHALAD HAS BEEN DEVELOPING his worldview for decades. Born in India's southern Tamil Nadu province, he acquired his inquisitiveness from his father, a prominent judge who was a voracious scholar of philosophy and literature. At age 19, in between earning a bachelor's degree in physics and a management degree at the Indian Institute of Management, C.K. worked as a manager of a Union Carbide battery plant. Later, while at Harvard Business School, he and classmate Yves L. Doz won attention with their 1975 doctoral thesis on multinationals, one of

Strategic	Bottom of the Pyramid	Co-Creation	Global Resource Leverage
Corporate America and Japanese competition, and Hamel published for the Future . Canon, Sony were beating bigger rivals, they argued, by setting ambitious goals to change the game and by motivating workers to fulfill them.	2004 The poor shall inherit the global economy, Prahalad argued in The Fortune at the Bottom of the Pyramid . Heeding his advice, most global consumer companies now are developing products with prices and technologies suitable for the world's 5 billion poor.	2004 The "company-centric" approach to innovation is dead, Prahalad and Venkat Ramaswamy argued in The Future of Competition . Instead, consumers are assuming a greater role in creating value through personalized, unique experiences. This requires new corporate organizational structures.	2006 Prahalad's next book will explain how nations like India, China, and Brazil will help transform industries by letting corporations shift more operations to remote locations and tap global resources . This will require innovative business models that will lead to high-quality goods and services at radically lower prices.
			

Data: BusinessWeek



DRIVEN Prahalad (center) says poverty can foster business innovation

Developing nations are at forefront of production in industries. An

the reasons Bharti can offer telecom ice so cheaply, Prahalad says, is that it keeps capital costs down by outsourcing everything from its network infrastructure to IT systems and promotes use of prepaid cards that generate cash up front. By making service affordable to the masses, Bharti can lure millions more subscribers, gaining economies of scale and enticing them to rely on cell phones instead of PCs for Internet access. "Somebody eventually clean up these business models and bring them to the U.S.," Prahalad predicts. "If high-tech and credit-card companies aren't following these trends, they will get hit."

into two groups. They returned several hours later with ideas for radical restructuring involving up to 50,000 layoffs. Then Prahalad admitted he made the article up.

But he got their attention. Then-CEO Jan Timmer soon launched a restructuring program with Prahalad supervising a series of meetings with 100 managers from each business unit. "His style was to apply all of the pressure he could," recalls Jan Oosterveld, a retired top executive at Philips who now teaches entrepreneurship at Barcelona's IESE Business School. "His style can be mean but effective." Philips has since turned itself around through major asset sales, layoffs, better product design, and a keener focus on core technologies.

When Prahalad started working with Indian conglomerates in 1994, "he was so sharp in his criticisms that it was like a punch in the gut," says CEO K. Vaman Kamath of ICICI Bank. "We thought we were leaders. He taught us that Indian banking was a complacent mess and that we would soon be competing with no abilities at all." Now ICICI exemplifies the kind of company Prahalad sees as the wave of the future. Developing financial software in-house to slash costs, it deployed 2,000 ATMs in urban neighborhoods and villages around the country. Taking a cue from microcredit agencies, ICICI organized thousands of self-help groups that provide loans of as little as \$100 to poor women for starting businesses. Today, ICICI ranks as India's dominant consumer bank, having boosted its customer base sevenfold, to 15 million, in six years, while pushing 75% of all transactions online. And ICICI's \$150 million microcredit business is profitable and expanding fast. ICICI hopes to use its low cost base to expand in Canada and elsewhere.

Prahalad thinks U.S. financial institutions can learn from ICICI and micro-lenders in Latin America. "Some 45 million people in this country don't have or don't use bank accounts or ATMs because they are too expensive. So they use check-cashing services, bond brokers, and other alternatives," Prahalad explains. "If the financial industry can bring the poor into the organized sector, there is a tremendous opportunity."

Prahalad sees big changes ahead in manufacturing as GM, Ford, and other auto makers increasingly outsource design and computer-simulated parts testing to Indian engineering services firms. India also is rich in microelectronics design. High-quality precision auto-parts makers specializing in small batch production. Before long, Prahalad predicts, Indians will be creating entire systems for Detroit—such as dashboards and chassis—that will cut development times and costs. "Companies don't understand yet that outsourcing isn't about importing jobs. It's about importing innovation," he says.

Healthier health care?

PRAHALAD THINKS GLOBALIZATION also can help reduce America's soaring health-care costs. That's one reason he's studying Indian hospitals such as Narayana Hrudaya, founded by cardiac surgeon Dr. Devi Shetty. Some reason its low costs can't be easily replicated elsewhere. The hospital is owned by Shetty's family. The hospital's 25 foreign-trained surgeons earn half what they could in the U.S. Or malpractice awards are rare in India, so insurance costs are low. But the hospital also operates for free on anyone who cannot pay and on any infant younger than one month old. In the rural poor, it runs 39 remote clinics and mobile-t

PLAYBOOK: BEST-PRACTICE IDEAS

C.K.'s Lessons for Executives

THINK BIG Set ambitious goals and then figure out how to mobilize the resources to achieve them—rather than the other way around. Most companies limit themselves because they focus primarily on what they believe they can afford.

CATER TO THE POOR People living in poverty, both in the U.S. and abroad, can be immensely important markets for consumer goods, telecom, and financial services. But they require high-quality products with appropriate technology and much lower prices.

DON'T GET BLINDSIDED Some of the most innovative business models are being pioneered in developing nations. Ignore them at your peril. Competitors who use these strategies will transform your industry.

RECONSIDER OUTSOURCING Don't look at it as exporting jobs but as importing innovation. It will allow you to speed up product development, gain new technology, slash costs, cut capital requirements, and boost flexibility.

Night's Sleep, Ultracheap

You tote your own luggage, the bed's a bit stiff, and the decor in the spartan rooms and lobby is reminiscent of a college dorm. Oh—and you can't buy a beer. For \$22 a night, the indiOne Hotel is one of a bargain. It's in the heart of Bangalore's top high-tech park, across from a new convention center and within a short distance of the research facilities of General Electric Co. and other big company SAP. The spotless rooms have free wireless Internet and each flat-panel TVs. Given the alternatives, the indiOne is a real deal: Rooms in booming Bangalore are so cheap that you'll be lucky to pay less than \$200 at a second-rate hotel. The indiOne is the vanguard of an ambitious experiment by the Indian Hotels Co., a unit of Tata Group known for its Taj luxury hotels. It is the result of a four-year development project led by management guru C.K. Prahalad. The goal is to re-invent the budget business hotel and prove it's possible to make money selling quality rooms at reasonable prices. In fact, the Bangalore indiOne is the most profitable of the group's properties, says Indian Hotels Vice-Chairman R. K. Krishna Kumar; it posts operating margins of about 35%, compared with about 35% for four-star hotels and 50% for five-star properties, he

says. The company is opening 10 more indiOnes in India and hopes that within the next five years it will have hundreds operating in cities around the world.

How does indiOne do it? By "not leaving a single rock unturned to dramatically crash the price," explains Prahalad. The biggest savings are in staff. The 100-room indiOne has seven



full-time employees, while a comparable U.S. motel has about 50 and a first-class hotel close to 130. IndiOne outsources everything from cleaning and laundry to computer support and cafeteria service. Guests stash valuables in lockers, cutting the need for security. Most bookings are made online, where rates are about 6% cheaper, and word of mouth usually is enough

BARE BONES The Bangalore indiOne is \$22 a night

to keep the hotel full. "We haven't spent a rupee on advertising," Krishna Kumar says.

Indian Hotels dubs its new room format "smart basic." To free up space in the very compact rooms, TVs are mounted on the wall. The furniture, flooring, and bathroom fixtures are made of easy-to-clean materials. Even so, guests are asked to eat only in the cafeteria, which offers cheap meals. "This is a great hotel if you know how to use it," says one regular, a Silicon Valley venture capitalist.

Indian Hotels got one lucky break: It bought the site before land prices in Bangalore and other Indian cities skyrocketed. But the company has an innovative strategy for coping with expensive real estate: It hopes to find one-acre lots by offering landowners a share of the hotels' profits. Indian Hotels is modifying the format to cater to families, rather than businesspeople, in tourist cities. Krishna Kumar believes the company can also adapt the concept in nations such as Pakistan, China, and Brazil.

What about America? Not yet. Pricing a room at a U.S. business hotel at \$22 would be a stretch, concedes Prahalad. But he believes strategies pioneered at indiOne could one day lower the price of a room in many big U.S. cities to around \$40.

—By Pete Engardio in Bangalore

with satellite links that so far have treated 17,000 patients. Some of the biggest savings come from its business model. In the U.S., the chief surgeon manages the entire patient process, from testing and diagnosis to supervising the operation, room, recuperation, and billing. Narayana works more like an assembly line: The surgeons perform only surgery. That may seem like a recipe for shoddy care. But Shetty assures it actually translates into fewer mistakes because specialists focus on what they do best. The 1.35% mortality rate for coronary bypasses and 2.7% rate for aortic valve replacements reported by Narayana are roughly half the average of U.S. hospitals, according to federal statistics, though those aren't the measures of quality care. "The importance of volume isn't understood in our industry," Shetty says. "A surgeon doing one or four operations a day does much better work than one doing three or four in a week." The factory approach also leads to economies of scale. The hospital uses all of its expensive CAT scanners and X-ray and magnetic-resonance machines to the max. "In the U.S., a lot of this infrastructure is used five days a week," says Shetty. "We use ours 14 hours a day, 7 days a week." This raises intriguing questions. If Indian doctors can effectively diagnose and treat heart conditions in farmers in distant villages, why can't American consumers use videoconferencing

to consult offshore specialists 24/7? Why can't an enterprising hospital chain bring Narayana's model to the U.S., or at least set up hospitals in Mexico or the Caribbean charging a fraction of U.S. prices? There are plenty of reasons this seems unlikely: Few Americans would tolerate the inability to collect big damages for mistakes, and it seems far-fetched that the U.S. medical Establishment would back sweeping liberalization to license offshore doctors to prescribe treatments. Or does such change seem impossible only because we are blinded by our "dominant logic"? Prahalad is confident that superior business models will eventually prevail. Just gaze into the kaleidoscope, give it a twist, and the implausible in the 21st century global economy becomes more realistic than you might ever imagine. ■

At the Feet of the Guru

For a recorded interview with C.K. Prahalad, about everything from the future of health care to the auto industry, please visit www.businessweek.com/extras.



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The Dirty Little Secret About Buybacks

All those share repurchases are doing investors little good. Here's why

BY DAVID HENRY

READING INTEL CORP.'S latest annual report, you might think the chipmaker has returned huge sums of cash to its shareholders through stock buybacks. Since 1990, the report boasts, the company has repurchased from shareholders "2.2 billion shares at a cost of approximately \$42 billion." That's a lot of stock—about a third of Intel's total shares outstanding. There's just one problem: Intel had as many shares, split-adjusted, at the end of 2004 as it did in 1990.

Much of the cash, it turns out, went to sop up the hundreds of millions of shares Intel was simultaneously issuing for employee stock options. Joseph Osha, a semiconductor stock analyst at Merrill Lynch & Co., says perhaps half the cash devoted to stock buybacks in general serves as little more than "backdoor compensation" for employees.

Companies have been happy to keep this little accounting detail quiet as they devote record sums to buybacks. Howard Silverblatt, a stock market analyst at Standard & Poor's (which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies), estimates that the companies in the S&P 500-stock index spent some \$315 billion on their own shares last year—nearly 2.5 times as much as in 2002. The high rate of buybacks will continue, Silverblatt predicts, because companies still hold troves of cash built up during the four-year economic expansion.

The logic of buybacks is sound. Companies with excess cash return some of it to shareholders by buying shares from them. Since there are fewer claims on the company, each shareholder's stake becomes proportionately larger. Plus, with-



Buyback Boom*

Many big tech companies have reduced share counts recently after years of treading water

*In companies' two most recently reported fiscal years

CISCO
\$19.3
BILLION

Lowered share count 10%, in part by dipping into savings

DELL
\$6.1
BILLION

Issued half shares as well as bought back

out buybacks, investors in some companies would see their stakes significantly diluted by options. "The point behind the stock buybacks is to return value to shareholders," says Intel spokesman Tom Beermann. "There is no other reason."

The problem, says Thomas M. Doerflinger, an equity strategist at UBS, is that you can't easily tell how much of what companies say they're spending actually gets to investors. In a recent report on what he calls "vanishing buybacks,"

Doerflinger found that the number of shares in the S&P 500 has continued to increase despite the bigger share-repurchase outlays by companies. In 2004, when companies reported spending some \$197 billion on buybacks—nearly 2% of the market value of the index—number of shares outstanding increased by 1.8%. In the 12 months through 2005, shares increased 0.7%, and only a third of the companies actually shrank their share counts by at least 1%.

consider Microsoft Corp. During its fiscal years ending in June, 2005, the company reported spending \$18 billion to buy back 674 million shares. At the time it issued 666 million shares for \$18 billion. In the end, Microsoft, which has some 10.6 billion shares outstanding, reduced its total count by a negligible amount—\$6.6 billion after tax. Yet Microsoft execs present the gross sums they used repurchasing stock as being on par with dividends they pay, including the \$33 billion special dividend in December, 2004. “Many companies are very



TEL
1.5
LION
shares 5%
of no net

MICROSOFT
\$11.4
BILLION
Bought back 436
million shares, but
issued 375 million

about the money they spent buying back stock, but they're not very vocal about what percentage of that money they use to counteract options,” says Merrill Lynch's Dana. Microsoft responded in a written statement that it regularly evaluates its buybacks and dividends to “best meet the interests of its diverse shareholder base.” To be sure, some companies, especially tech outfits, have been ramping up their buybacks enough lately to cut their share counts by more than their options raise

them. During the 12 months through June 2005, 108 companies in the S&P 500 reduced their counts by 2% or more, up from 55 companies the year before. And 41 reduced shares outstanding by at least 5%, including Intel. Cisco Systems Inc. cut its count by 6%, and Dell Inc. pared its outstanding shares by 4%. Dell Chief Financial Officer James M. Schneider says in the fiscal year ending in February the company will buy back four times as many shares as it grants in options. “The last couple of years we had all of this cash flow, and there's no real need to add cash to the [\$12 billion] coffers,” he says.

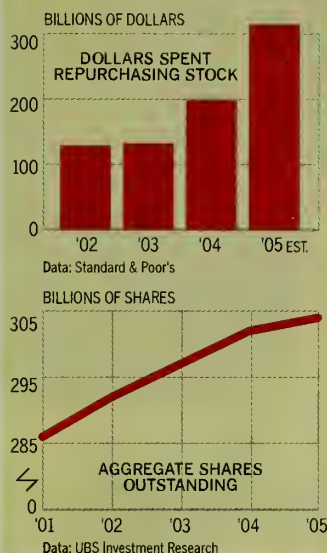
At first glance this seems unambiguously positive. Bill Miller, the portfolio manager of Legg Mason Value Trust who has beaten the market for 15 years straight, says the move is good for Dell, which his fund didn't own as of its most recent disclosure. “Their stock is cheap, and they're putting their cash where it's worth more.” He says tech outfits in general are moving in the right direction, from being the worst abusers of buybacks to becoming leaders in paring down their cash and share counts with buybacks. Buybacks will have more impact on share counts in the future because more companies, such as Microsoft, have scaled back options grants ahead of new rules requiring their cost be accounted for as an expense.

But reducing the share count can pose other problems in gauging a company's performance. That's because earnings per share, the most widely followed measure of profit growth, rises as share counts drop. The math is simple: The fewer the shares, the greater the earnings per share (EPS), assuming total profit, or net income, stays the same. Huge share-count reductions can juice EPS growth—but some investors might not think to check both the net and per-share figures.

The discrepancy can be big. Dell and Cisco both cut their share counts sharply—and as a result, their EPS grew much faster than their net income. In their most recent quarters, based on the non-standard accounting that the companies

WHERE DID THE MONEY GO?

S&P 500 companies are spending record sums buying back their own stock, but that's not reducing the number of shares outstanding



prefer, Dell's EPS grew 18%, while its net income grew 12%; Cisco's EPS grew 19%, while its net grew just 8%.

Which company's strong EPS growth rate is more likely to continue? Investors would have to dig through cash-flow statements and balance sheets to find out. There they would see that Dell has been funding its buybacks with cash it's making now. Cisco, on the other hand, has been tapping its savings as well. During the past 12 months, as Cisco spent \$10 billion buying back stock and boosting earnings per share, it used as much as \$4 billion of the \$18 billion of cash and investments it had built

up in past years. In other words, Cisco is using cash it generated long ago to boost its EPS today. “That's not the kind of growth you can count on to continue because it requires past resources,” says Charles W. Mulford, an accounting professor at Georgia Institute of Technology.

THE CASE FOR DIVIDENDS

CISCO'S VICE-PRESIDENT for investor relations, Blair Christie, says investors understand the sources of the EPS growth. Officials have a limit in mind for how much of Cisco's cash they might use, but they haven't disclosed the amount.

The larger question is, why fiddle around with buybacks at all if the goal is to return cash to shareholders? Why not just issue dividends? “Dividends are a much, much more transparent and real way to return cash to shareholders,” says UBS' Doerflinger. Tech executives say they prefer buybacks so they'll have the flexibility to adjust cash cushions in the event of industry downturns or investment opportunities. Once dividend payments are initiated, they're pretty much sacred. But Merrill Lynch's Osha says investors prefer dividends to buybacks because they want evidence that companies really will distribute profits to their investors. “Buybacks,” he says, “don't represent the same long-term commitment to returning wealth to shareholders.” If companies are afraid of commitment, investors might be, too. ■



HAVE LAPTOP, WON'T TRAVEL
Gilot fields calls for Office Depot and AAA from her Arizona home

shoring jobs are independent contractor positions offered by outsourcing companies. The agents on the hook for their health care, computer equipment, training—and background checks.

Outsourced homeshoring jobs grew 20% year, to 112,000 jobs, estimates tech-market researcher IDC, and will reach 330,000 by 2010. “Homeshoring’s underestimating sibling, homeshoring about to hit a growth spurt,” says IDC analyst Stephen Loynd. Office Depot (page 25), McKesson and J. Crew all use homeshoring agents. Homeshoring

is less likely to risk the accent fatigue, cultural disconnection, and customer rage that offshoring can inspire. That’s not to mention the mounting security fears (your private data—credit-card and Social Security numbers, medical and brokerage records—go overseas, they’re beyond the reach of U.S. law).

LOYAL WORKFORCE

FOR A FRACTION of the cost, companies get superior labor. Home workers, sometimes called cyberagents—are being culled from a labor pool that, without broadband, was marooned from the Internet Business. The biggest group of homeshoring agents are educated, stay-at-home moms who were previously workaholics. MIAs because they lived in rural areas, couldn’t afford child care, or were unable to contort their lives into mandatory face-time schedules. More than 75% of home agents have some college, versus 40% in call centers. Home-based agents are also far more experienced and racially diverse, and more loyal (table).

Aside from mothers with young children, virtual call-center providers like Alpine Access, LiveOps, Willow, and Working Solutions are tapping into other members of the hidden labor force: it includes former military spouses, seasoned retirees living hard-core year down South, computer-savvy, disabled veterans—even corporate executives looking to go back to work.

“I have a daughter at home. That’s like \$40,000 a year,” says LiveOps home-based agent Adrienne Byrne. She b

Call Centers In the Rec Room

“Homeshoring” takes off as moms and others provide an alternative to offshoring

BY MICHELLE CONLIN

THREE YEARS AGO, WHEN the offshoring debate was in full fury, the director of vendor relations at 1-800-FLOWERS.com ran a pilot project to see if the company should be taking advantage of the new labor arbitrage. Within weeks, the trial in India bombed. For the executive in charge, Lou Orsi, it was a reminder that customer service is as much about psychology as technology. Florists often double as condolence therapists, interior design coaches, and relationship strategists. “The folks were difficult to understand,” says Orsi. “We were afraid that we would lose sales, and we couldn’t risk that.” The company also needed to pour on the labor during spikes like Valentine’s Day. (When it came to answering customers’ e-mails, though, the dazzling prose of the Indians—many of them PhDs—outshone that of the Americans, most of whom had gone only to high

school. So Orsi left some of the e-mail jobs overseas).

The phone work stayed in the U.S. But not just in brick-and-mortar call centers. Instead, Orsi looked for another way to cut costs. He soon realized he could capitalize on a different and far less controversial option: sending the jobs to a U.S. outfit that specializes in a new trend called homeshoring.

More and more, companies are moving customer service jobs out of high-overhead call centers and into what is possibly the lowest-overhead place in the U.S.: workers’ homes. The savings are about more than just real estate, toilet paper, and coffee supplies. JetBlue Airways is perhaps the most famous practitioner; all of its 1,400 reservation agents work from home. But they are employees. Most of the new home-

Home agents pay for their own computers, training, and health care

about \$1,200 biweekly working 40 hours a week out of the 4,000-square-foot home in Brookfield, Conn., that she shares with her husband, an executive in national finance.

Homeshoring also provides a flexible, on-time workforce. Shifts can last as little as 15 minutes. Agents are paid only for the time spent on the phone—a 21st-century piece-rate system. Technology companies monitor worker performance with the same precision as the machinery on their assembly lines. While a roadside call-center worker typically costs \$31 an hour, including overhead training, home agents cost only \$21, according to IDC. Home agents are also more productive. Willow CEO Angie Selden says her company's home agents make sales that are up to 25% higher than in call centers, and their customer satisfaction rates are up to 40% better.

Another factor powering the trend is the awareness that it can cost up to six times as much to replace a customer as to keep him, points out Washington, D.C.-based Telework Coalition senior vice president Jack Heacock. Thus offshoring is giving way to a new "multi-shore" or "rightshore" strategy: match-

Customer Service? Phone Home

Call center jobs aren't just moving to India. The latest hot spot? U.S. workers' homes, where employers get high-quality labor for less cost.

WORKFORCE	CALL CENTER	HOME-BASED
Percentage of agents with some college	20%	75%
Average age	18-29	35-45
Average years of work experience	5-7 years	10-15 years
Annual attrition	100%	20-30%

Data: Alpine Access, BusinessWeek

ing consumers to a workforce that best serves them.

The advantage for employees is an end to days where more time is spent commuting in a car than lounging on the living room couch—or having only enough for a trip to McDonald's after job-related expenses are paid. "I could get a job at the mall, but the \$8.50 an hour would all be taken up by day care and gas," says Crystal Gilot, a military spouse who works for

Willow from her home in Sierra Vista, Ariz., near Fort Huachuca. Her two kids are trained like soldiers not to utter a syllable when she's on the phone. She says that by taking calls for AAA roadside assistance and Office Depot, she can earn up to \$20.70, with incentives. But she usually averages \$15 an hour—extra income that will be helpful when Gilot's husband leaves in six months for his second tour in Iraq.

Of course, there's a dark side. While home agents earn more than their brick-and-mortar counterparts (most earn \$10 to \$15 an hour without benefits vs. \$7 to \$9 with benefits in a call center), they are

also going it alone in the workplace jungle. Critics say homeshoring is thrusting more jobs into the global discount-labor bazaar.

In a scenario that's becoming increasingly familiar, Working Solutions cyberagent Jacqueline Lesane has a slice of the good life, including her own Atlanta home with a pool. But she and her husband have no health insurance. For now, she's willing to make the trade-off: no benefits, but more flexibility and control. ■

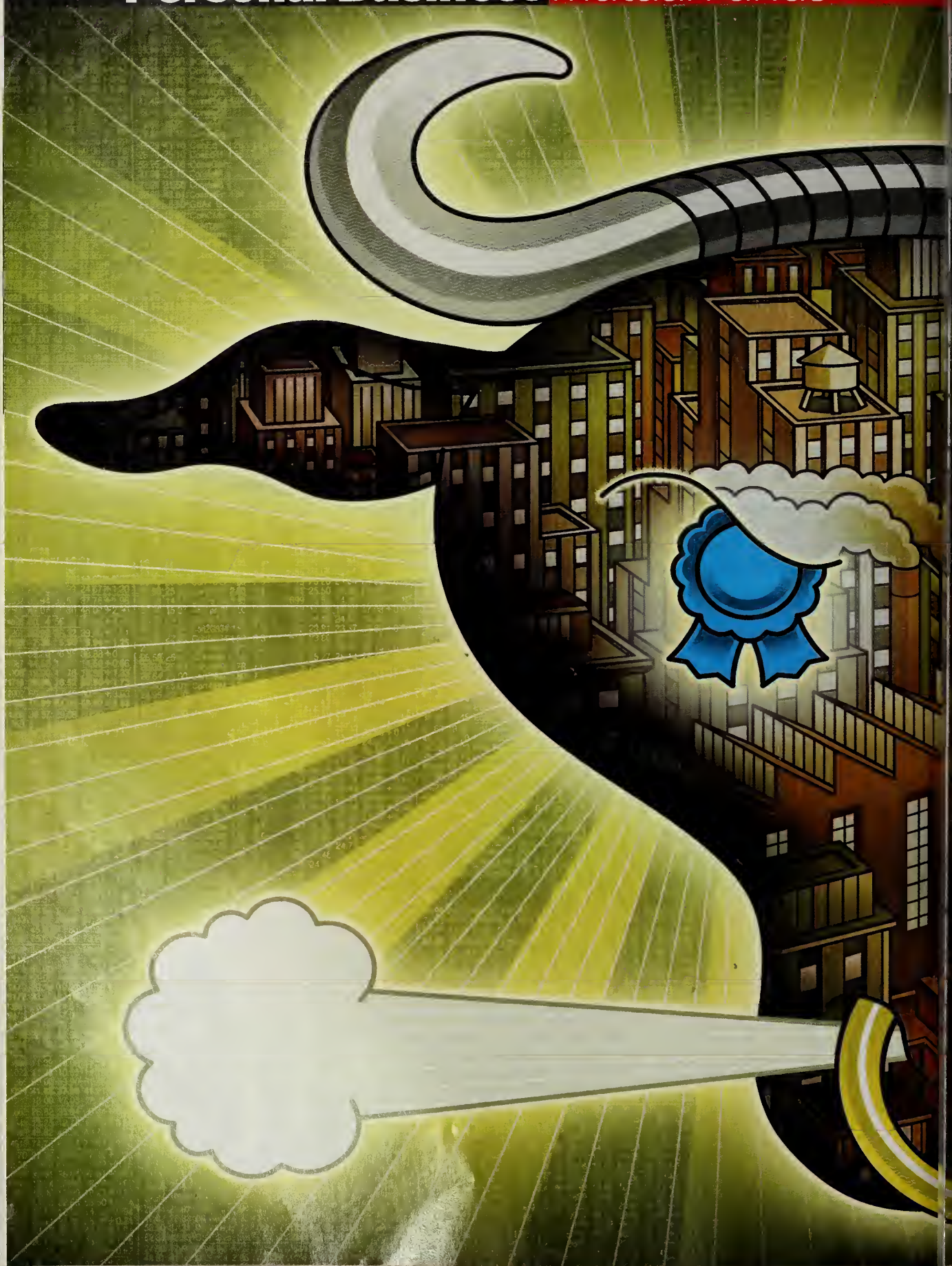


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a ridiculously fast shine.*

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Personal Business Mutual Funds



The Easy Way to Find The Best

did the work, and you get the results: Our Mutual
and Scoreboard is all you need. **BY LAUREN YOUNG**

AURORA, ORE., IS A LONG WAY from Wall Street, but you can't grow hazelnuts and timber in Manhattan. That's why Jeffrey Auxier, a top-flight but little-known mutual fund manager, works out of that rainy outpost. When he's not busy with the \$103 million Auxier Focus Fund, he's tending his trees. Last fall, Auxier's 108-acre farm produced more than 100,000 pounds of hazelnuts at record price of more than \$1 a pound. His mutual fund hasn't done too badly, either: The large-company value fund, which owns American International Group, Coca-Cola, and Citicorp, delivered an annualized return of 9% for the past five years, vs. the Standard & Poor's 500 stock-index' minuscule 0% (through Dec. 31). Minding nuts and trees is more similar to investing in blue chips than you might think. "There's no instant gratification in farming," he says. "You plant and you wait. Most of the days you are not harvesting." While Auxier Focus isn't a fund that typically comes to mind when you name top-performing value funds, its portfolio stands tall against its peers, like the 80-foot Douglas Firs that domi-

nate Auxier's farm. *BusinessWeek* awards the tiny \$103 million fund an A rating for the large-cap-value category alongside better-known offerings from mutual-fund industry heavyweights such as American Century, Dodge & Cox, Merrill Lynch, and Oakmark.

That's the beauty of *BusinessWeek's* Mutual Fund Scoreboard: It turns up funds you might never have heard of otherwise. From a list of more than 5,600 mutual funds, the Scoreboard identifies a select group in each asset category that earned the best risk-adjusted returns in the past five years.

The Scoreboard, which is available at *BusinessWeek* Online and updated monthly, is an ideal starting point to find the cream of equity and bond mutual funds. Need to add some foreign stock or fixed-income funds to your portfolio? Go to the Scoreboard. It's also the place you should turn to if you want to check up on your portfolio to make sure the funds you own are meeting your expectations. If not, use it to find a replacement.

CRUNCHING THE NUMBERS

TO GET A RATING, a fund must have at least five years' performance history. With data prepared for *BusinessWeek* by Standard & Poor's, we measure each fund's monthly performance for the past 60 months. When a fund fails to beat the return for U.S. Treasury bills, it earns negative marks, which are subtracted from the total return to come up with a risk-adjusted return. Funds are then ranked by their risk-adjusted returns from A (superior) through F (very poor). The A funds are an elite group—the top 7.5%, but don't overlook funds rated B+ or even B.

BusinessWeek awards two ratings to each fund. An Overall Rating evaluates the performance of, say, equity funds against all other stock funds. You'll find plenty of real estate funds among the 207 funds earning overall A ratings, which isn't a surprise given the hot property market of the past few years. But to build a diversified portfolio of funds, you need a lot more than real estate.

That's how Category Ratings can help. These are especially useful when you're trying to find a good fund in a category that has been out of favor, such as large-cap growth and tech, and unlikely to show up in the Overall Ratings. Most of the category ratings for equity funds are in the table on pages 80 and 81. You'll

BusinessWeek online For more on fund managers and fund ratings, please go to www.businessweek.com/extras

Personal Business Mutual Funds

find the rest, plus the bond fund ratings, at businessweek.com/extras.

While past performance is no guarantee of future results, what you often find in top-rated funds is a strong aversion to risk that tempers the volatility of returns. "We know there are many great opportunities in the market, but we look for ways to make sure we don't get blown up," says Barry James, another little-known manager whose \$20 million James Equity and \$207 million James Balanced: Golden Rainbow Funds receive A ratings in the large-company growth and the domestic hybrid categories.

CLOSE TABS

HIS FIRM, near Dayton, Ohio, runs an analysis of the securities in its portfolio every weekend to assess the impact of interest rate moves and other macroeconomic trends. Stocks are also rated individually against their peers on valuation yardsticks such as price-to-book value,

then assigned a valuation target. When that stock becomes expensive, usually it is sold.

Because smaller companies have dominated the market for the past six years—an unusually long cycle—there are better opportunities in large-company stocks, James says. And among bigger players he's especially excited about financial firms such as Goldman Sachs because it's benefiting from the mergers-and-acquisitions activity that is "cranking up like there's no tomorrow," he says.

The allure of large-company stocks also extends overseas. "The percentage of stocks that are large and midsize [in the fund] is substantially higher than it was three years ago," says James Hunt, lead manager of the \$240 million Tocqueville International Value Fund. "That's where we are finding the best values."

Tocqueville, an A-rated fund for the foreign stock category, looks for companies or industries that are out of favor,



Tops in Their Class

BusinessWeek's Mutual Fund Scoreboard rates funds based on the past five years' total returns, adjusted for risk. Here we show the equity funds that received A ratings for best risk-adjusted returns against similar funds. You can find more categories, plus overall equity ratings and all the bond fund ratings at businessweek.com/extras.

FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*	FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*	FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*
» All-Cap		» Foreign		» Large-Cap Blend	
COLUMBIA STRATEGIC INVESTOR Z CSVFX	15.0%	OAKMARK EQUITY & INCOME I OAKBX	11.3	EXETER TAX MANAGED A EXTAX	
FAIRHOLME FAIRX	13.0	PERMANENT PORTFOLIO PRPFX	11.5	FIDELITY CAPITAL APPRECIATION FDCAX	
HODGES HDPMX	16.6	T. ROWE PRICE CAPITAL APPRECIATION PRWCX	11.4	FIDELITY EXPORT & MULTINATIONAL FEXPX	
MATTHEW 25 MXXVX	12.6	USAA BALANCED STRATEGY USBSX	6.1	FIDELITY FIFTY FFTYX	
TEXAS CAPITAL VALUE & GROWTH TCVGX	17.4	VALLEY FORGE VAFGX	7.7	JANUS CORE EQUITY JAEIX	
YACKTMAN YACKX	14.0	VANGUARD WELLESLEY INCOME INV. VWINX	6.5	JENNISON 20/20 FOCUS A PTWAX	
YACKTMAN FOCUSED YAFFX	13.9	VANGUARD WELLINGTON INV. VWELX	6.8	LEGG MASON EQ TR VALUE PRIM LMVTX	
» Domestic Hybrid		VILLERE BALANCED VILLX	6.6	MP 63 DRIPX	
AMER. BEACON BALANCED PLANAHEAD AABPX	7.6	» Large-Cap Growth		MANAGERS AMG FIRST QUAD TAX MGD. MFQTX	
BERWYN INCOME BERIX	9.8	AIM INTERNATIONAL SMALL COMPANY A IEGAX	22.3	MARATHON VALUE MVPFX	
BRUCE BRUFX	30.5	BLACKROCK INTL. OPPORTUNITIES INV. A BREAX	14.0	MASTERS SELECT VALUE MSVFX	
CORNERCAP BALANCED CBLFX	6.3	BOSTON CO. INTERNATIONAL SMALL CAP SDISX	19.5	MERRILL LYNCH LARGE CP. CORE C MCLRX	
DELAWARE DIVIDEND INCOME A DDIAX	7.6	COMMONWEALTH NEW ZEALAND CNZLX	15.2	PARNASSUS INCOME EQUITY INCOME PRBLX	
DODGE & COX BALANCED DODBX	9.9	DRIEHAUS INTERNATIONAL DISCOVERY DRIDX	12.0	PIONEER FOCUSED EQUITY Y ASEPX	
EQUITRUST SRS. MANAGED B FBMGX	7.0	FIDELITY CANADA FICDX	15.8	PRUDENT BEAR BEARX	
EXETER PRO BLEND EXTENDED TERM A MNBAX	6.4	FIRST EAGLE OVERSEAS A SGOVX	19.0	RUSSELL LIFEPOINTS EQ. AGG. STGY. D RELDX	
FIDELITY BALANCED FBALX	8.1	ISHARES MSCI AUSTRALIA INDEX EWA	18.5	STOCKCAR STOCKS INDEX SCARX	
FIFTH THIRD STRATEGIC INCOME INSTL. MXIIX	8.0	LAZARD INTL. SMALL CAP OPEN LZSMX	13.9	THOMPSON PLUMB GROWTH THPGX	
FIRST FOCUS BALANCED FOBAX	7.4	MFS INTERNATIONAL NEW DISCOVERY A MIDAX	13.7	TORRAY TORYX	
FRANKLIN CUSTODIAN FD. INCOME A FKINX	8.3	MORGAN STANLEY INSTL. INTL. SMALL A MSISX	15.4		
GREENSPRING GRSPX	9.5	OAKMARK INTL. SMALL CAP I OAKEX	20.6		
HILLMAN TOTAL RETURN HCMTX	6.8	OPPENHEIMER INTL. SMALL COMPANY A OSMAX	19.1		
INCOME FUND OF AMERICA A AMECX	8.1	QUANT FOREIGN VALUE ORD. QFVOX	16.2		
JAMES BALANCED: GOLDEN RAINBOW GLRBX	8.0	TOCQUEVILLE INTERNATIONAL VALUE TIVFX	15.7		
LEUTHOLD CORE INVESTMENT LCORX	9.3				

How investing
is like farming:
You plant
and you wait.
Most [days]
you are not
harvesting."

—Jeffrey Auxier,
Auxier Focus Fund

such as drug stocks. "There's a lot of skepticism about pipelines and generic competition," says the New York-based Hunt, whose fund is up an annualized 15.3% for the past five years. But pharmaceutical companies generate lots of cash. One example is France's Sanofi-Aventis, the result of a recent merger. It has a strong franchise in vaccines as well as a potential blockbuster drug, Acomplia, which assists in weight control and smoking cessation. "The market has lowballed its ability to gain efficiencies and reduce costs," Hunt says.

Managing risk in foreign markets is tricky, though, mainly because accounting and disclosure standards aren't as rigorous as in the U.S. Currency fluctuations add another layer of volatility to the mix. To keep the \$625 million Driehaus International Discovery Fund from bouncing too much, manager Lynette Schroeder tries to maintain individual stock positions below 3% of assets. The fund, also

A-rated in the foreign stock category, doesn't allow her country allocations to exceed its benchmark, the MSCI Growth Index. Schroeder, who divides her time between New York and Chicago, is adding to the fund's positions in Korea, Taiwan, and Thailand. "As oil stabilizes, consumers will spend less on heating and more on restaurants and stores," says Schroeder, whose fund has gained an annualized 11.9% in the past five years.

PLAYING THE RATE GAME

HIGHER INTEREST RATES can have an impact on many sorts of funds. In the financial category, David Ellison, manager of the A-rated FBR Small Cap Financial Fund, says he's investing in smaller banks such as Washington Federal, BankUnited Financial, and Hudson City Bancorp, whose shares have been down because of rising rates. He thinks they'll make more money in a higher-rate environment, not less. "I feel better [about

	AVERAGE ANNUAL TOTAL RETURN*
DISCIPLINED EQUITY FDEQX	1.9
U.S. GROWTH LEADERS A GXXAX	5.0
ROAD OF AMERICA A AGTHX	3.1
SHORT CORE EQUITY N HGRAX	1.3
CITY JALCX	1.5
SEMIER GROWTH & INCOME S JADGX	1.7
IN FORTY INSTL JACAX	1.2
IX	1.6
GROWTH TRUST PRIMARY LMGTX	8.8
US MFOCX	1.2
OWTH MGRIX	1.3
ST CENTURY MXXIX	7.1
SECTOR ROTATIONAL A PSRPX	9.6
WTH PRGRX	1.9
MGD. GL. EQUITY S RTGSX	2.8
IE GROWTH STOCK PRGFX	1.4
ICA PREMIER EQUITY INV. TEQUX	1.7
IR JORGAN GROWTH INV VMRGX	1.3
RIMECAP VPMCX	2.9
ADVTG. CAPITAL GROWTH INV. SLGIX	3.8
Small-Cap Value	
DIVIDEND VALUE A PNEAX	11.8
VALUE A PDLAX	8.4
ON LG. CAP VAL. PLANAHEAD AAGPX	8.6
JURY LARGE CO. VALUE INV. ALVIX	7.4
RY VALUE INV. TWVLX	8.8
S INV. AUXFX	9.0
STOCK DODGX	11.0
ITY INCOME AAA GABEX	7.1
US ADVANTAGE HCMAX	8.8
ATE LEADERS TRUST B A LEXCX	7.1
CLASSIC VALUE A PZFXV	12.4
CH LARGE CP VL C MCLVX	9.0
LECT I OAKLX	10.4

FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*
RIVERSOURCE DIVERSIFIED EQUITY INC. A INDZX	9.8
SEQUOIA SEQUX	7.3
TCW GALILEO DIVIDEND FOCUSED N TGIGX	7.9
VANTAGEPOINT EQUITY INCOME VPEIX	7.2

» Mid-Cap Blend

DELAWARE AMERICAN SERVICES A DASAX	14.7
HUSSMAN STRATEGIC GROWTH HSGFX	12.0
IMS CAPITAL VALUE IMSCX	15.5
LEGG MASON SPECIAL INVST. PRIMARY LMASX	12.0

» Mid-Cap Growth

BARON IOPPORTUNITY BIOPX	9.8
COLUMBIA ACORN SELECT A LTFAX	11.0
FEDERATED KAUFMANN K KAUFX	9.3
FIRST AMERICAN MID CAP GROWTH OPP. Y FISGX	8.4
LEGG MASON OPPORTUNITY TR. PRIMARY LMOPX	11.9
MFS NEW ENDEAVOR A MECAX	8.6
MUNDER MID CAP CORE GROWTH A MGOAX	9.1
NEEDHAM GROWTH NEEGX	7.6
T ROWE PRICE MID-CAP GROWTH RPMGX	7.9
VANGUARD EXTENDED MARKET INDEX INV. VEXMX	6.9

» Mid-Cap Value

AL FRANK VALUX	17.1
FIDELITY ADVISOR LEVERGED CO. STOCK FLSAX	24.1
HOTCHKIS & WILEY MID-CAP VALUE I HWMIX	17.7
RS VALUE RSVAX	17.4

» Small-Cap Blend

AMER. CENTURY SM. COMPANY INV. ASQIX	16.1
BRIDGEWAY MICRO CAP LIMITED BRMCX	16.2
BRIDGEWAY ULTRA SMALL COMPANY BRUSX	27.3
DREYFUS PREMIER ENTERPRISE A DPMGX	17.8
SATUIT CAPITAL MGMNT. MICRO CAP SATMX	21.4

FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*
» Small-Cap Growth	
BJURMAN BARRY MICRO CAP GROWTH BMCFX	13.5
BOGLE SMALL CAP GROWTH INV BOGLX	12.3
COLUMBIA ACORN USA Z AUSAX	14.3
COLUMBIA ACORN Z ACRNX	13.0
FBR SMALL CAP FBRVX	21.5
HENNESSY CORNERSTONE GROWTH HFCGX	15.3
MUNDER MICRO CAP EQUITY A MMEAX	15.2
N/I NUMERIC INVESTORS EMERGING GROWTH NIMCX	11.9
OBERWEIS MICRO CAP OBMGX	19.8
PERRITT MICRO CAP OPPORTUNITIES PRGFX	24.2
WASATCH MICRO CAP WMICX	19.3
WILLIAM BLAIR SMALL CAP GROWTH N WBSNX	16.8

» Small-Cap Value

BERWYN BERWX	19.9
BRIDGEWAY ULTRA SMALL CO. BRSEX	23.7
DIAMOND HILL SMALL CAP A DHSCX	20.3
FIFTH THIRD MICRO CAP VALUE INSTL. MXAIX	20.7
FRANKLIN MICROCAP VALUE FRMCX	21.1
HOTCHKIS & WILEY SMALL CAP VALUE I HWSIX	25.0
N/I NUMERIC INVESTORS SM. CAP VAL. NISVX	21.1
RS PARTNERS RSPFX	23.6
SCHNEIDER SMALL CAP VALUE SCMVX	24.0

» World

CGM FOCUS CGMFX	23.3
IVY CUNDILL GLOBAL VALUE ADV. ICDVX	10.4
OAKMARK GLOBAL I OAKGX	18.0
POLARIS GLOBAL VALUE INVESTOR PGVFX	16.4
TEMPLETON GLOBAL SM. COS. A TEMGX	13.3
VANGUARD GLOBAL EQUITY VHGX	12.0

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1, 2001-Dec. 31, 2005

Data: Standard & Poor's

Personal Business Mutual Funds

bank stocks] now than I did two years ago, when rates were quite low," says the Boston-based Ellison. His \$240 million fund is up an annualized 18.8% in the past five years.

Of course, rising interest rates have an even bigger impact on bond funds. Normally, funds with longer maturities provide higher yields but with greater risk. Now, after a long period of rate hikes by the Fed, yields from short-term bonds are much the same as those from long-term bonds. That's why bond funds with the flexibility

Look beyond big names: Lots of little-known funds earned top grades

to change the kinds of bonds they invest in are staying short. "You are getting some respectable yields without going long term," says John W. Thompson, lead manager of the \$30 million Thompson Plumb Bond Fund, an A-rated bond fund.

Portfolio managers are also shying away from lower-quality bonds and moving into the debt of safer, higher-rated issuers. "We aren't going to compromise the quality of the fund to chase yields at this point," says Peter Kwiatkowski, co-man-

ager of the \$160 million Fifth T Strategic Income Fund.

Perhaps a better alternative (except tax-deferred retirement account) are free municipal bond funds. "They're cheap and attractive," says Mary M. director of fixed income at T. Rowe P Associates, which offers five A-rated m funds. The Scoreboard features dozen A-rated funds to choose from, from likes of Fidelity Investments and V guard to unknowns Dupree and While their names may be unfamiliar, can be assured that the top grades th funds receive from *BusinessWeek's* M al Fund Scoreboard mean they're h quality choices. ■

TOOLS

How Do Your Picks Compare?

When you get an account statement from your mutual fund or broker, you find out how much you made or lost but not how the fund fared against its peers. How can you tell if it's a gem or a clunker?

Easy: Just look it up on *BusinessWeek's* Mutual Fund Scoreboard (bwnt.businessweek.com/mutual_fund/). You can find a fund by typing in its name or symbol in the box at the top of the page.

Not sure exactly which one you want? Type in the fund family, such as Oakmark (example below).

Now you have six Oakmark stock funds. Moving across the screen, you get a trove of data. The ratings, Overall and Category, come first, then assets, sales charges, expenses, pretax returns, turnover, cash, and the fund's risk level. Note the Oakmark Equity & Income Fund I: It has a high turnover (suggestive of frequent trading) yet a very low risk profile.

Want to drill down further? Click on the fund's name, and a pop-up box appears. Included are the fund's 10 largest holdings, its best and worst quarters of the last five years, and its aftertax returns. Need more? There's a link to Oakmark's Web site, where you can read fund reports, manager commentaries, and even download investment applications.

The Scoreboard lets you scan the entire fund universe or sort the funds by 50 individual equity and bond fund categories. Select Utilities funds, and you'll get data on 28 utilities funds in the Scoreboard. The initial sort is alphabetical, but by clicking on the headers, such as expense ratio or 10-year return, you can rearrange the layout to whatever criteria you like, such as funds with the lowest expenses or highest return.

You'll get the hang of it in no time. Once you do, you'll probably want to come back once a month for an update. —Lauren Your

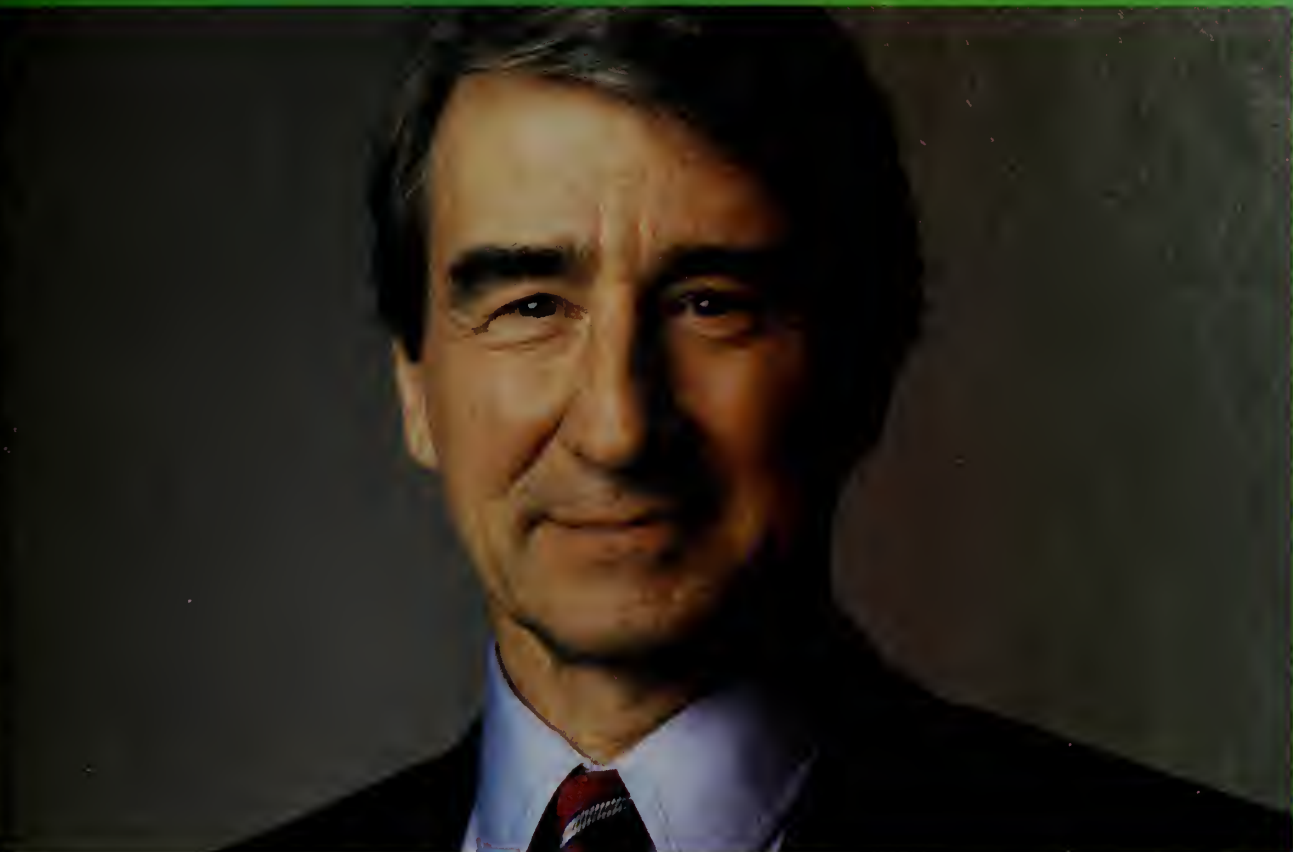
Using the Screens

Type in a mutual fund's name or its ticker symbol to bring up its vital statistics and *BusinessWeek* ratings.

Use the category drop-down menu to view funds by 51 categories, including domestic hybrid, foreign, and world.

Click on a column heading to sort funds by expenses, returns, or other criteria.

oakmark		GO	All fund categories		GO													
Enter a fund name or symbol			Select a fund category															
All Funds		Data as of December 31, 2005																
Click column heading once to reorder from highest to lowest. Click twice to reorder from lowest to highest.																		
Fund Name	Fund Overall Type Rating	Fund Category	BW Category Rating	Assets (\$ Mil.)	1 Yr. Assets Change (%)	PRETAX RETURNS										Non Investment Grade Assets (\$ Mil.)		
						Sales Charge	Expense Ratio	1-Mo.	3-Mo.	Year-to-date	12-Mo.	3-Yr.	5-Yr.	10-Yr.	Turnover %		Cash %	Risk
Oakmark Global I (OAKGX)	Equity A	World	A	1,988.1	28.1	0.00a	1.20	3.2	3.3	13.2	13.2	24.9	18.0	NA	Low	NA	Low	NA
Oakmark International Small Cap I (OAKBX)	Equity A	Foreign	A	1,019.4	25.0	0.00a	1.41	5.8	8.8	21.3	21.3	33.8	20.6	14.8	Average	NA	Low	NA
Oakmark Equity & Income I (OAKBX)	Equity B+	Domestic Hybrid	A	9,272.4	16.0	0.00a	0.89	1.9	0.4	8.6	8.6	13.9	11.3	13.7	High	NA	Very Low	NA
Oakmark International I (OAKIX)	Equity B+	Foreign	B+	5,643.0	26.9	0.00a	1.11	3.3	2.5	14.1	14.1	23.3	10.3	12.1	Low	NA	Average	NA
Oakmark Select I (OAKLX)	Equity B+	Large-cap Value	A	8,037.7	7.9	0.00a	1.00	1.9	4.6	4.8	4.8	14.1	10.4	NA	Low	NA	Low	NA
Oakmark I (OAKMX)	Equity B	Large-cap Value	B+	8,198.2	-10.4	0.00a	1.03	0.4	1.2	-1.3	-1.3	11.4	6.9	8.4	Low	NA	Low	NA



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"screen" for investment ideas according to various criteria, including 10 pre-defined Standard & Poor's strategies.

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CODE: MRCBWF

TOW3851

Wish You Were Here. Oh—You Are

Multigenerational travel can be a good way to bring a far-flung clan together. **BY TODDI GUTNER**

CAN 13 PEOPLE, RANGING in age from 4 to 75, coming from Arizona, California, Colorado, New York, and Ohio, easily get together for a week's vacation? I had no idea, but it was my job to find out.

My father had asked me to find a spot for him to treat our extended family to a reunion getaway for his 75th birthday. He got the idea from his friends who had started to vacation with their children's families. Multigenerational travel is a fast-growing segment of the leisure travel industry. In a 2005 survey of 1,655 travelers, 35% of grandparents report having taken at least one vacation with grandchildren during the previous 12 months,

up from 30% in 2003, according to Ye-sawich, Pepperdine, Brown & Russell, an Orlando travel marketing firm.

My dad figured this vacation would be a great opportunity for our far-flung family—which included his fiancée, three daughters, two sons-in-laws, four grandchildren, and his brother and sister-in-law—to reconnect and relax. It was. We spent the week at the Half Moon resort in Montego Bay, Jamaica. I realize that we were quite lucky and that for many a trip like this could end up horribly for everyone. Looking back, I can see a number of reasons why our trip turned out as well as it did.

APPOINT A TRIP PLANNER Putting one or two people in charge of coordinating the trip can pave the way to a more harmo-

nious experience. The person chooses the dates, books the lodging, and may handle the money and deposits.

At the time of our escape, my children were 4 and 5½. My father and sisters understood that a long airplane journey crossing multiple time zones would be difficult for my kids. We chose a Caribbean island instead of a cruise, a popular choice for multigenerational travel, because my husband and I get seasick. My older sister's only request was that we go during the Christmas break so her girls, 11 and 13, wouldn't miss school.

ENLIST A TRAVEL AGENT Once we made the where and when decisions, I enlisted the help of Barbara Nichuals, president of Bayside Travel in Bronxville, N.Y. You'll want to find someone like Nichuals who specializes in planning family trips and has visited resorts. Knowing the specifics of properties firsthand, such as the size of the rooms, quality of the food and service, and availability of activities, minimizes the chances people will be unhappy. What's more, travel agents can often leverage their relationships with resorts and cruise lines to get better accommodations or other upgrades.

Our school as a group were many.

FAMILY CAMPS

Back to the Woods, With the Kids

If packing the kids off to summer camp fills you with nostalgia for your own days around the campfire, why not go with them? More and more camps allow the whole family to join in the fun, games, and—who knows?—maybe even a chorus or two of *Kumbaya*. "You get to relive your childhood," says Jessica Tolmach Plett, a magazine advertising executive from Larchmont, N.Y., who for the past two summers

has spent a week with her husband and two sons, 12 and 7, at Cheley Colorado Camps in Estes Park, Colo., a camp she first attended at age 15. "If you loved camp, family camp brings back all those wonderful experiences."

You have lots of camps to choose from—including, very possibly, the one you went to or the one you have your eye on for your child. Of the 2,400 camps the American Camp Assn. accredits nationwide, 25% have programs for families, up 28% since 1998. You can start your search at Web sites sponsored by the ACA (CampParents.org) and Budget Travel magazine (budgettravelonline.com). Just as now is a good time to research camps for kids, this is also when you should be looking at family camps. "By April, many are booked," says Marla Coleman, director of Camp Echo in Burlingham, N.Y., which offers family weekends throughout the year.

Most of the programs are run by sleep-away camps for kids that open their doors—and tents—to families for a few weeks every summer, often after regular

camp ends. Many offer traditional activities including canoeing, horseback riding, art and crafts, and archery. Some specialty camps have family sessions, too. During week-long periods in August, the Cazade Performing Arts Camp in Cazadero, Calif. teaches family members to circus acrobatics.





...n wanted golf and tennis; my sis-
...e and I requested water sports and
...aseback and bicycle riding; and my
...t and stepmom-to-be looked for-
...d to shopping and spa treatments.
...father wanted to relax on the beach
...well as do some sightseeing. My hus-
...d and I were also hoping for babysit-
...i or a kids' club. Half Moon had it all.
CONSIDER EVERYONE'S BUDGET We were
...y my father could foot the entire bill.
...H set a \$30,000 limit, which was to in-
...elle travel accommodations, food, and

...clowns and offers instruction in dance,
...ater, and music. Campers also get a
...nce to perform—solo, in ensembles, and
...he open microphone. Other specialty
...ps focus on foreign languages or even
...anic farming.

...Don't expect resort-style amenities.
...families often use the same facilities as
...ular campers. That may mean sleeping in
...ks and sharing communal bathrooms.

...Sometimes, families are assigned
...separate cabins or—in the case of
...Cheley Colorado Camps—a
...Conestoga-style covered wagon
...outfitted with four beds.

...Don't expect around-the-clock child
...care, either. True, many family camps
...offer separate counselor-led activities for

...children. Cazadero
...features "Kid City,"
...an all-day program
...that includes
...clowning, singing,
...musical

FAMILY CAMP
Tolmach Plett
and friend Anne
Berkowitch in
Colorado



...instruments, and "messy art," says family camp
...director Trina Gulliford. But for the most part,
...these camps emphasize family activities. "We
...prefer that either mom or dad do most activities
...with the kids," says Don Cheley, director of the
...Cheley Colorado Camps, which costs \$375 a
...week for kids ages 4 to 8 and \$675 for everyone
...else. (Cheley requires campers to be at least 4).
...A week at Cazadero runs about the same: \$380
...for 3-to-5-year-olds, \$595 for 6-to-18-year-olds,
...and \$660 for adults.

...What motivates generations to go to camp
...together? Mom or dad may like the nostalgic
...experience. They may also want to give the
...kids a taste of camp before sending them off
...on their own. Regulars say they enjoy living in
...nature and the communal experience. During
...the day, families participate in group activities
...and eat together in a dining hall. At night they
...relax by the campfire and stage talent shows.
..."You say goodbye to the rest of the world and
...just spend time with your family," says
...Tolmach Plett. You're never too old for s'mores.

—Anne Tergesen

activities for everyone. With that in mind,
Nichuals suggested an all-inclusive resort
because we would know the cost in ad-
vance. Make sure you inquire about
group discounts. Many resorts offer low-
er rates for parties of eight or more.

PLAN EARLY My task was made easier
because I started planning nearly a year
in advance. We had our choice of rooms
at any of the resorts we considered, and
we were able to book good flight times at
reasonable prices. Given the long lead
time, we purchased travel insurance that
would refund about 70% of the cost if ill-

ness or other un-
foreseen circum-
stances forced us to
cancel the trip. The
cost varied, from
\$105 to \$190 per

person, depending on the age
of the traveler. We paid about
\$1,300 to insure our trip.

COORDINATE YOUR TRAVEL

Choose a destination that
everyone can reach easily.
We didn't want anyone to
be up all night traveling.
Our flights arrived about
the same time, allowing
us to rendezvous at the
airport and take a
minibus to the resort.
You also want to consid-
er the distance be-
tween airport and hotel.

Ours was an easy 15-minute drive.

DEFINE TOGETHERNESS IN ADVANCE

Being on a family trip doesn't have to
mean being together all the time. Find
a place that allows for individual
rhythms as well as getting together.

Half Moon has large private villas to
cater to family reunions and wed-
dings. A villa, complete with a private
pool, maid, and cook, would have been
quite luxurious, and a bit cheaper than
the seven hotel rooms we rented side
by side. But to my father's credit, he
knew my sisters and I needed our own
space and figured separate rooms
would avoid family tension.

While we enjoyed meeting for
breakfast, staking out our beach
lounge chairs together, and pairing off
for activities, we all cherished our late
afternoon family time alone just to col-
lect ourselves before dinner. As a
group, we also took a couple of fun day
trips to waterfalls and caverns.

For the first time in 30 years, I cele-
brated the New Year with my father
and two sisters. We left Half Moon with
wonderful memories. ■

(BOTTOM) PHOTOGRAPH BY MALCOLM PLETT

EDITED BY TODDI GUTNER

CAMERAS

SLIM, WITH A WIDE-ANGLE LENS

EASTMAN KODAK has come up with a slick way to pack a big zoom into a slim and stylish camera: Add a second lens. In addition to a conventional 3X optical zoom lens, Kodak's \$399 EasyShare V570 dual-lens digital camera sports the first ultrawide-angle lens in a pocket camera. Alone, the wide-angle lens is useful for shooting in small rooms, group photos, or sweeping landscapes. But both together give it the magnification of a 5X zoom lens.

Here's a cool trick: Using guidelines on the 2.5-inch display, the camera helps you compose and shoot a 180-degree panorama in just three shots. It then stitches the three together, saving them as single photo, something no other consumer camera can do. All that in a 5-megapixel camera that is only 5 ounces and is 0.8-inch thick. —Larry Armstrong



TWO LENSES
Kodak's V570

MUTUAL FUNDS

HELP IN DODGING HEAVY LOADS

WITH MUTUAL FUNDS that have front-end loads, the more you invest, the lower the sales charge. But brokers have not always kept on top of the discounts available at various "breakpoints" or amounts invested, and this info is often buried in prospectuses. As a result, shareholders have been shortchanged by more than \$130 million, says the NASD, which regulates brokers. That's why the NASD has introduced a new Mutual Fund Breakpoint Search Tool at tools1.nasd.com/nbst. It can help you find the best deals. —Anne Tergesen



INVESTING

Lively S&P Castoffs

IT'S WELL-KNOWN THAT COMPANIES added to the Standard & Poor's 500-stock index get a quick price boost because the big index funds are forced to buy their stocks. What about the castoffs? It turns out that the misfits may be the better bet.

William Hester, a senior research analyst at money management firm Hussman Funds tracked the returns of companies added and deleted from the benchmark the past eight years. Even factoring in 100% losses for bankrupt companies such as Laidlaw and Polaroid, the median annualized gain for stocks after they were ousted was 14.2% through the end of December, 2005, compared with 4.6% for new members and 4.8% for the entire S&P 500. The biggest winner: airline AMR, with nearly 1400% total return since it was booted from the index in early 2003.

The phenomenon is pretty easy to explain. While investors' high hopes are baked into the prices of new S&P 500 stocks, they typically don't expect much from former ones. In fact, by the time those stocks are kicked out of the index, most have already taken a beating in the market. Says Hester: "Neglected and underappreciated companies often have more life than investors expect." —Abel Moidu

BEVERAGES

LOOSE TEA IN A BAG? Sounds like a contradiction in terms. But an Asian innovation is becoming available in the U.S. Instead of ground tea in a flat bag, a few companies are using spacious, pyramid-shaped bags that let full-leaf gourmet tea expand when steeped in hot water. You get richer flavor with a bag's convenience. A 15-bag box of Adagio Teas costs \$10 at stores or adagio.com

—Gerry Khermouch

RICHER FLAVOR
Adagio
tea bags



BY GENE G. MARCIAL

A VALUE MENU AT OUTBACK STEAKHOUSE ROPES IN BOOMERS.

iPASS IS POISED FOR FAST GROWTH IN WIRELESS CONNECTIONS.

WEB ACE PERFICIENT BENEFITS FROM A JUMP IN TECH OUTLAYS.

Outback: Set to Sizzle

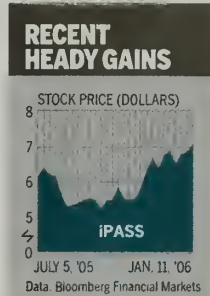
WHEN YOU INVEST IN Outback Steakhouse (OSI), you're not only putting your money where your mouth is. You're also buying into a venture-capital strategy that, say some pros, has turned Outback into an undervalued value play. This chain of 333 restaurants in 50 states and 21 countries is "in a turnaround mode" and has also made it attractive on the investment side, says Marion Schultheis of investment firm J. & W. Friedman, which owns shares. Its stock price has risen from 34 in October to 44 on Jan. 11. Six weeks ago, Outback's management introduced a low-priced "value menu" in the Midwest. The goal: rope in more baby boomers. "Early signs suggest the new menu is driving increased traffic," notes Schultheis. She figures Outback earned \$2.26 a share in 2005 and will make \$2.60 in 2006 and \$3.10 in 2007, up from \$2.08 in 2004. Howard Friedman, Billings, Ramsey says that for six years Outback has been investing in small startup eateries that have performed well. The deals have made the stock "extremely undervalued" based on a sum-of-the-parts assessment, he says. On assets alone, Penney figures, Outback is potentially worth 65 a share, his 12-month target. He says the smart-money crowd is bound to recognize the value of cash-rich Outback soon. Its unusual venture-capital strategy, he argues, has disguised the real value of Outback's restaurant assets.



More Than a Passing Interest in iPass

SHAMROCK CAPITAL ADVISORS, led by Roy Disney and Stanley Gold, knows how to get investors' attention. On Aug. 1 this column featured Intrado, in which Shamrock acquired a 6.2% stake. Intrado was trading at 15 back then; it's at 24 now. Shamrock's latest buy: an 11% stake in iPass (IPAS). Disney and his group favor obscure companies that have leadership positions in their markets and strong cash flow, says Eric Appell of investment firm Merriman Smith, who owns shares and rates iPass a buy. iPass provides companies, including Eastman Kodak and General Electric, with software that lets employees wirelessly connect their offices and the Internet. "We like the business iPass

is in," its sizable cash balance of \$180 million, and its \$30 million in free cash flow, says Mike McConnell of Shamrock. iPass might use its cash to buy back shares, he adds. Appell says iPass is an attractive play in fast-growing wireless connectivity and security. He expects it to earn 26¢ a share in 2006, up from an estimated 22¢ in 2005. He sees the stock, now at 7, rising to at least 9 this year.



Perficient Helps Customers Be Net-Efficient

PERFICIENT (PRFT) stock has soared from 5.30 in May to 9.60 on Jan. 11. The reason: a sales surge. The company helps 425 enterprises adapt their systems to the Web using IBM's WebSphere software. Acquisitions and growth drove up revenues in 2005 by 65%, to \$100 million. By yearend 2006, says CEO Jack McDonald, sales could hit \$200 million. Collin Gills of Canaccord Adams, who rates the stock a buy, with a 12-month target of 12, says Perficient is benefiting from the jump in corporate tech outlays. That, plus acquisitions, will drive up profits and sales, he says. Perficient is in talks with several companies that have an aggregate \$250 million in annual revenues. Although Perficient trades at a high price-earnings ratio of 24 times Gills's 2006 estimate of 41¢ a share (vs. an estimated 30¢ in 2005 and 19¢ in 2004), the stock is still undervalued relative to its peers, based on the company's projected earnings-growth rates in 2006 and 2007. Gills figures Perficient will earn 49¢ a share in 2007. Morton Meyerson, ex-CEO of Electronic Data Systems and the biggest holder in Perficient, with 12%, says Perficient is a long-term growth play "much like Dell." Meyerson is impressed with its "strong management, which helped the company survive the tech crash." ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

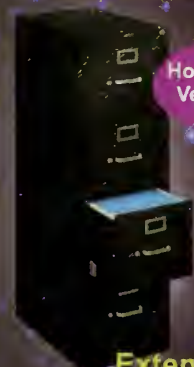
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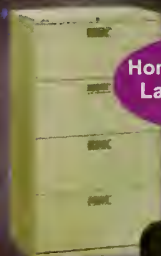
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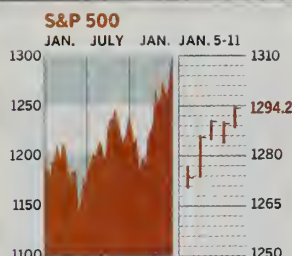
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Personal Business Figures of the Week

STOCKS



COMMENTARY

It was a banner week for stocks as major indexes set multiyear highs. The Dow broke 11,000 despite weakness at Alcoa and Dupont, where the effects of Hurricane Katrina and Rita bit into earnings. Investors took weaker-than-expected jobs data as a sign that the Federal Reserve's interest-rate hikes are almost over. Buyers also bet on stronger tech spending in '06.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED JAN. 10

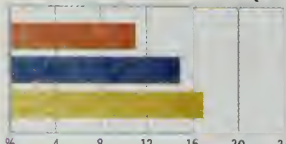
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED JAN. 10

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	JAN. 11	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1294.2	1.6	3.7	9.4
Dow Jones Industrials	11,043.4	1.5	3.0	4.6
NASDAQ Composite	2331.4	3.0	5.7	12.1
S&P MidCap 400	772.4	2.4	4.7	21.7
S&P SmallCap 600	368.6	2.9	5.1	18.7
DJ Wilshire 5000	12,996.3	1.9	4.0	12.0

SECTORS

	JAN. 11	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	779.1	1.9	5.0	12.3
BW Info Tech 100**	404.1	2.4	6.2	12.6
S&P/BARRA Growth	619.4	1.7	3.8	8.6
S&P/BARRA Value	670.2	1.6	3.5	10.2
S&P Energy	401.1	2.6	7.6	43.0
S&P Financials	440.1	1.7	3.2	9.1
S&P REIT	162.7	3.5	6.3	21.0
S&P Transportation	248.0	-1.0	-0.7	5.8
S&P Utilities	162.2	-0.4	1.6	17.8
GSTI Internet	214.5	3.2	4.6	31.3
PSE Technology	886.5	3.5	6.0	20.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Gold Mining	17.8	Oil & Gas Refining	100.6
Homebuilding	13.6	Oil & Gas Exploration	78.2
Constr. & Engineering	10.6	Oil & Gas Drilling	74.9
Thriffs & Mortgage Finance	9.7	Oil & Gas Equipment	72.0
Pharmaceuticals	9.6	Divsfd. Metals & Mining	64.1

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	14.1	Latin America	77.9
Diversified Emerg. Mkts.	8.3	Natural Resources	56.5
Japan	8.1	Precious Metals	49.9
Diversified Pacific/Asia	7.4	Diversified Emerg. Mkts.	46.8
LAGGARDS		LAGGARDS	
Utilities	1.1	Domestic Hybrid	8.9
Miscellaneous	1.3	Miscellaneous	10.6
Domestic Hybrid	1.8	Large-cap Blend	11.4
Communications	1.9	Large-cap Value	12.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
U.S. Global Invs. Gold	20.2	Profunds Ultra Japan Inv.	92.8
ProFunds Precs. Mtls. Inv.	18.7	ING Russia A	87.0
U.S. Gl. Invs. Prec. Mnls.	17.7	T. Rowe Price Latin Am.	85.3
Van Eck Invs. Gold A.	16.8	iShares MSCI Brazil Idx.	82.9
LAGGARDS		LAGGARDS	
Ameritor Investment	-12.5	Ameritor Investment	-65.0
Bridgeway Micro Cap Ltd.	-11.6	American Heritage Grth.	-42.9
Guardian UBS Sm. Cap Val. A	-9.4	ProFds. USh. Mid Cap Inv.	-32.4
ProFds. Mble. Tlcmms. Inv.	-9.1	ProFds. USh. Sm. Cap Inv.	-28.1

GLOBAL MARKETS

	JAN. 11	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1590.1	0.9	5.2	
London (FT-SE 100)	5731.5	0.3	2.0	
Paris (CAC 40)	4890.5	1.1	3.7	
Frankfurt (DAX)	5532.9	0.2	2.3	
Tokyo (NIKKEI 225)	16,363.6	0.0	1.6	
Hong Kong (Hang Seng)	15,650.9	3.0	5.2	
Toronto (S&P/TSX Composite)	11621.0	1.0	3.1	
Mexico City (IPC)	19,160.4	2.6	7.6	

FUNDAMENTALS

	JAN. 10	WEEK AGO	YE
S&P 500 Dividend Yield	1.75%	1.78%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	18.8	18.4	2
S&P 500 P/E Ratio (Next 12 mos.)	15.0	14.7	1
First Call Earnings Surprise*	9.13%	9.51%	6

TECHNICAL INDICATORS

	JAN. 10	WEEK AGO	YE
S&P 500 200-day average	1214.3	1210.9	Pos
Stocks above 200-day average	69.0%	64.0%	Nr
Options: Put/call ratio	0.59	0.72	Neg
Insiders: Vickers NYSE Sell/buy ratio	3.92	3.92	Neg

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Furnishings Retail	-13.6	Automobiles	
Educational Services	-9.2	IT Consulting	
Health-Care Facilities	-7.0	Auto Parts & Equipment	
Health Care Supplies	-6.6	Photographic Products	
Wireless Services	-6.6	Food Wholesalers	

INTEREST RATES

KEY RATES

	JAN. 11	WEEK AGO	YE
Money Market Funds	3.83%	3.83%	
90-Day Treasury Bills	4.30	4.19	2
2-Year Treasury Notes	4.42	4.30	
10-Year Treasury Notes	4.45	4.34	
30-Year Treasury Bonds	4.63	4.54	
30-Year Fixed Mortgage †	6.06	6.08	

†Barr's Quoted

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Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	3.84%	
Taxable Equivalent	5.49	
Insured Revenue Bonds	3.89	
Taxable Equivalent	5.56	

THE WEEK AHEAD

INDUSTRIAL PRODUCTION

Tuesday, Jan. 17, 9:15 a.m.

EST » December factory output is forecast to have increased by 0.6%, following a 0.7% jump in November. That's the median forecast of economists polled by Action Economics. The average monthly operating rate probably pushed up to a more than five-year high of 80.6%, from 80.2%.

CONSUMER PRICE INDEX

Wednesday, Jan. 18, 8:30

a.m. EST » Consumer prices for goods and services most likely rose 0.2% in December, after a 0.6% dip in November. Less food and energy, prices probably rose 0.2% for a third straight month.

BEIGE BOOK Wednesday, Jan. 18, 2 p.m. EST » The Federal Reserve releases its review of regional economic activity before the Jan. 31 monetary policy meeting. There is unanimity among economists polled by

Action Economics that the Fed will lift interest rates to 4.5%, from 4.25%. In the coming months economists see the central bank pausing after another quarter-point hike at the Mar. 28 meeting.

RESIDENTIAL CONSTRUCTION

Thursday, Jan. 19, 8:30 a.m.

EST » Housing starts are expected to fall back to an annual rate of 2.03 million in December, after edging up to a rate of 2.12 million in the prior month.

The BusinessWeek production reached 270.0 for the week of Dec. 31, an increase of 13.3% year ago. Before calculation four-week moving average, the retreated to 271.6.

BusinessWeek on

For the BW50, more investor data, and the components of the production index visit www.businessweek.com/magazine/e

The Companies

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A Real-Life Willy Wonka

HERSHEY Milton S. Hershey's Extraordinary Life of Wealth, Empire, and Utopian Dreams

By Michael D'Antonio; Simon & Schuster; 305pp; \$25

The American landscape is littered with towns named for their corporate landlords: Alcoa, Tenn.; Kohler, Wis.; Corning, N.Y.; Kennecott, Alaska. Perhaps none is more clearly identified with a company than Hershey, Pa., where Chocolate Avenue intersects Cocoa Avenue and the very air is redolent of

Hershey's Kisses. Built by Milton S. Hershey as a planned utopia in the early 1900s, the manicured burg featured electrified, centrally heated homes owned by well-paid company workers and a state-of-the-art milk-chocolate factory. There was a free playground and zoo, a medical clinic, and athletic teams outfitted by the company. A model school for orphan boys, supported by a foundation that held the majority of company stock, was the centerpiece.

But humanity has had an ambivalent relationship with utopias: After a while, some people want change while others insist things should always stay the same. In 1937, Hershey workers decided their pay was too low. They organized a union, took over the plant, and halted production. Four days into the strike, a mob of several thousand Hersheyites, joined by dairy farmers who were losing milk sales, stormed the factory and drove the strikers out, attacking them with clubs, stones, and pitchforks. Within two years, the company had agreed to a union contract. Then in 2002, an even more dire threat appeared: The foundation decided to sell its Hershey stock, now worth as much as \$10 billion, and diversify its portfolio. But once the idea of the stock sale became public, the 13,000 townspeople worried that it could mean a shuttered factory and the end of a way of life. A highly politicized struggle followed, complete with protest marches and a legal challenge from the state of Pennsylvania. In the end, the board backed down—and utopia dodged a bullet.

The dramatic events are recounted in Michael D'Antonio's *Hershey: Milton S. Hershey's Extraordinary Life of Wealth, Empire, and Utopian Dreams*. The book is a richly detailed biography of the founder and an absorbing history of the Hershey company, its two model towns, philanthropy, and business success. On the negative side, readers might wish for more comparison with other company-created communities.

Milton Hershey began in the candy business with stores in Philadelphia and New York. Both were failures. Then, during a trip to Denver, he learned how to make caramels, which he began producing and selling on the streets of Lancaster, Pa. A

British importer happened to sample them, and then placed a huge order. By the early 1890s, Hershey employed 1,400 in three factories. But it was apparent to Hershey that the future lay not in caramels but in chocolate, which was already claiming a mass market in Europe. By 1896, chocolate candy had become Hershey's primary focus.

Britain's Cadbury was particularly instructive. Not only had that company found riches in large-scale production of chocolate, but its Quaker owners were benevolence personified. Among other things, the Cadbury family were generous employers who built a model town, Bournville. The combination of an affordable, wholesome product—backed

by British temperance groups and the teetotaler Cadburys as an alternative to alcohol—and the founders' perpetual dog goodism combined to make Cadbury "perhaps the single most beloved brand in Great Britain," says the author.

It's hardly a stretch to see Hershey, Pa., as a U.S. version of Bournville, particularly since imitation was key to Hershey's methods. He perfected his wares by luring skilled workers from other successful chocolatiers and even sending spies into the plants of rivals. All the same, Hershey was an innovator, says D'Antonio: After years of experimentation, he came up with his own method for making a distinctive milk chocolate that could be stored for months without spoiling. Sales soared, topping \$10 million by 1913.

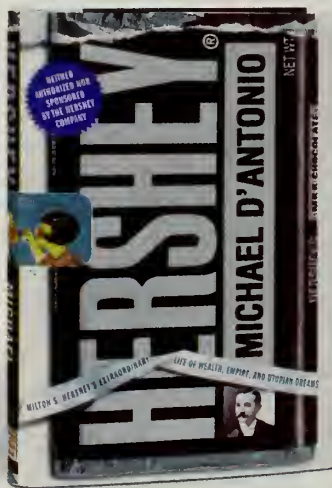
**Hershey's
"philanthropic
dictatorship"
blended
commerce and
good works**

Hershey again blended commerce and good works in Hershey, Pa., a giant sugar mill, a railroad, and another model town. Then in the 1920s, new rivals including Mars Inc. captured three-quarters of the candy market. Still, Hershey remained so profitable that it seemed to defy the Great Depression, providing jobs for hundreds

with ambitious hometown construction projects.

After Milton Hershey's death in 1945, the town lost some of its novelty. In the 1960s, the foundation used its considerable resources to build a medical school and large hospital complex. But even as newcomers swelled the town's population, residents continued to feel that the old ways had been the best. In Hershey, said longtime resident Monroe Stover, "we live under... a philanthropic dictatorship. We would have a much better world if there were more of them."

—By Hardy



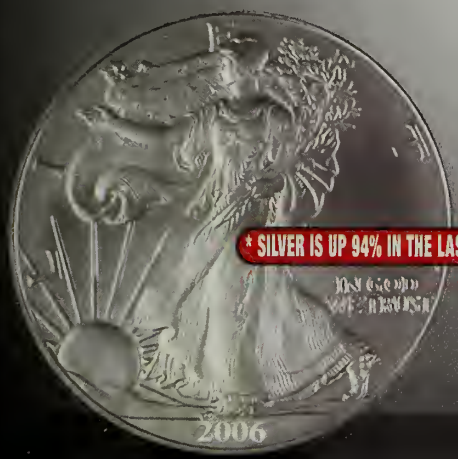
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WITH MARIA BARTIROMO

Picking Blackstone's Brain

WHEN STEVE SCHWARZMAN, CEO of private equity powerhouse The Blackstone Group, lunches with you at the Four Seasons in New York, expect interruptions. As we talked, Bernard Schwartz of Loral stopped by to say Happy New Year. Then dealmaker Ron Perelman table-hopped over. Between schmoozing, Schwarzman made provocative points about the boom in private equity buyouts. (Later, though, he declined to comment on reports that Blackstone and HP are looking at a deal for Computer Sciences.)

With so much money flowing into private equity funds, do managers feel pressure to make deals?

In the high end of the market, where we're involved, there's not enormous pressure because you can always buy larger and larger companies. In the medium-size part of the market...there is enormous pressure on general partners.

With all of the money that has been raised, how does that change the types of deals you're looking at?

In the olden days, doing a billion-dollar buyout deal was a major event. Now we're looking at \$10 billion and \$15 billion deals.

Do you have a targeted return, and what's your exit strategy?

We don't set up a deal unless we think we can make at least a 20% annual return on investment. We also like to make around 2½ to 3½ times our money. And we either exit by taking a company public or we sell the company to another buyer or we take out dividends with supplementary borrowings. Sometimes that's called a recapitalization, but fundamentally it's using the company; continue to own the same percentage ownership and just take out money.

Could you see yourself getting more active like, for example, Carl Icahn at Time Warner?

Attacking companies, that's not our business. We in private equity use inside information. That's our lifeblood. We sign confidentiality agreements. We work closely with corporations to figure out if it's a sensible transaction.

Has energy peaked?

I don't know if energy has peaked, but it has shown such increase that we viewed it as prudent to take what are unusual levels of gains off the table. Maybe we'll be wrong and have earned 8 to 10 times our money. Our view is that 7 [times our money] is probably enough in a year.

Has real estate peaked?

You always hate to call tops, but...I think you can pressure that the rate of increase in real estate is not sustainable.

Some people say housing represents 70% of economic growth and if that's the case and we see housing slow....

Companies are in great financial health right now—a low level of inflation. There's much more inflation in the economy than is being measured by the Fed, and corporations are getting more profitable.

first time in many years the all start increasing prices. And with come at record levels, they will invest in equipment and plant expansion, and that will be a slight cooling housing getting softer.

The buyout boom in the '80s was by opportunistic buyers of broker companies. But today corporations are lean and flush with cash. Are the pickings getting slimmer?

We haven't found that to be true yet, and one of the major reasons is Sarbanes-Oxley. What we're finding is that it's a dual tyranny of Sarbanes-Oxley and the relentless disapproval of the quarterly earnings that

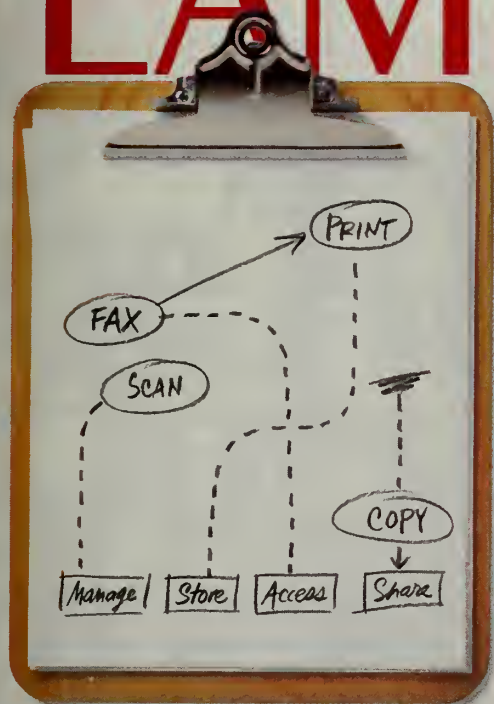
tional investors require. As a result of those factors, more boards, and particularly senior managements, are happy to go private because they aren't enjoying running public companies. They're not able to do some of the things they know should be done to fix their companies. If it requires earnings to be depressed for two or three quarters of losses, they'd rather, in many cases, not do the right thing because if they do the right thing, they'll be penalized by shareholders or they'll be put under more scrutiny by the board or they feel they'll have more legal liability under Sarbanes-Oxley. Sarbanes has companies very risk-averse. So we've been lucky beneficiaries in the private equity business because of those factors, which make our lives, frankly, very easy.

Maria Bartiromo is the host of CNBC's Closing Bell.



ON THE PROWL
Schwarzman says he's eyeing ever-larger deals

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IdeasViewpoint

BY BRUCE NUSSBAUM

Davos Will Be Different

The traditional format—plenaries and sessions, dinners and parties—will continue at the 2006 World Economic Forum, but the conversation is changing dramatically. Sure, the gathering, which opens in Davos, Switzerland, on Jan. 25, is still the *über*-klatch for high-profile economic and political elites. Bill Gates will talk about philanthropy again.

Google's troika of Eric Schmidt, Sergey Brin, and Larry Page will throw its usual Friday night bash at the Kirschner Museum. Members of the Bush Administration's Cabinet and a parade of congressional Republicans will show up to talk about free trade and terrorism. Bill Clinton will probably preside over one of his late-night gabfests. And a series of private dinners, parties, and secret meetings among politicians and CEOs at the four-day event will reach a climax at the wild Saturday night soirée in the Conference Center and adjoining pool building.

Yet the content of the 2006 meeting will be a far cry from that of recent Davos gatherings. Previously, discussion at the World Economic Forum revolved around two main economic themes: outsourcing and China. This year innovation replaces outsourcing and India replaces China in the dialogue. These changes are significant because they signal a new stage in global economic development. CEOs are starting to move beyond their obsession with cutting costs by outsourcing their supply chains. In fact, that process is nearly completed at many Western European and most big U.S. and Japanese companies. China, the main beneficiary of outsourcing, has gotten top billing at Davos conferences for the past half decade.

Not so in 2006. This year there are an unprecedented 22 sessions under the theme of "Innovation, Creativity, and Design Strategy." There is a special series of six workshops just for CEOs. They include "Building a Culture of Innovation," "What Creativity Can Do For You," "A World Without Intellectual Property," and "Making Innovation Real." And there are larger sessions on such topics as "Prepping for the Creative Economy." Tellingly, the main discussion on outsourcing will come in a panel examining the outsourcing of innovation.

This shift in agenda reflects the fact that CEOs and the corporations they run can no longer generate value by competing solely on cost and quality, so they are turning to innovation. When everyone has outsourced, all competitors are equal. So Six Sigma, TQM, CRM, and other cost- and

reliability-based business methodologies are being replaced by new design-based, consumer-centric management methodologies. One of the central topics of discussion at Davos in 2006 is how to best implement innovation.

Enter India, which is throwing the Saturday night bash this year as it launches its own global brand, "India Everywhere." Western companies are outsourcing knowledge-economy production to India, and that increasingly means outsourcing innovation as much as software writing. Indeed, many top managers equate India with outsourcing innovation in the same way they equate China with outsourcing manufacturing.

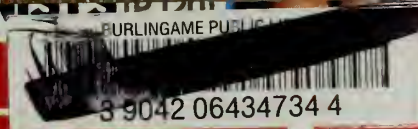
No question, it is easy to overstate this shift. Motorola Inc. is doing some of its best cell-phone innovation in Shanghai and Beijing; while Chinese PC maker Lenovo Group is designing startling new ways of interacting with computers. Baidu.com and SINA.com, the Google and Yahoo! of China, have devised original user interfaces for their Web sites. Chinese universities are graduating an army of engineers and designers who may make Chinese products more innovative in the future.

But not yet. China remains largely a Wal-Mart supplier, while India has a huge, sophisticated English-speaking creative class that supplies brainpower to the world economy. Most U.S. corporations, management consultants, design firms, venture-capital outfits, and Silicon Valley companies have Indians in top positions. U.S. and other foreign companies are establishing research and development labs and design centers in Bombay and elsewhere, fueling a resurgent economy. The likes of GE Healthcare, General Motors, and Intel are in India to innovate.

It may be that China morphs from commodity producer to innovator. But at this moment, as the fulcrum of the global economy moves from outsourcing to innovation, from cost-cutting to creating, Davos will celebrate India.

Assistant Managing Editor Bruce Nussbaum oversees BusinessWeek Online's Innovation & Design channel.

**Innovation
is the new
byword, and
India has
grabbed top
billing from
China**



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The Future of Outsourcing (P.50)

How it's transforming whole industries and changing the way we work

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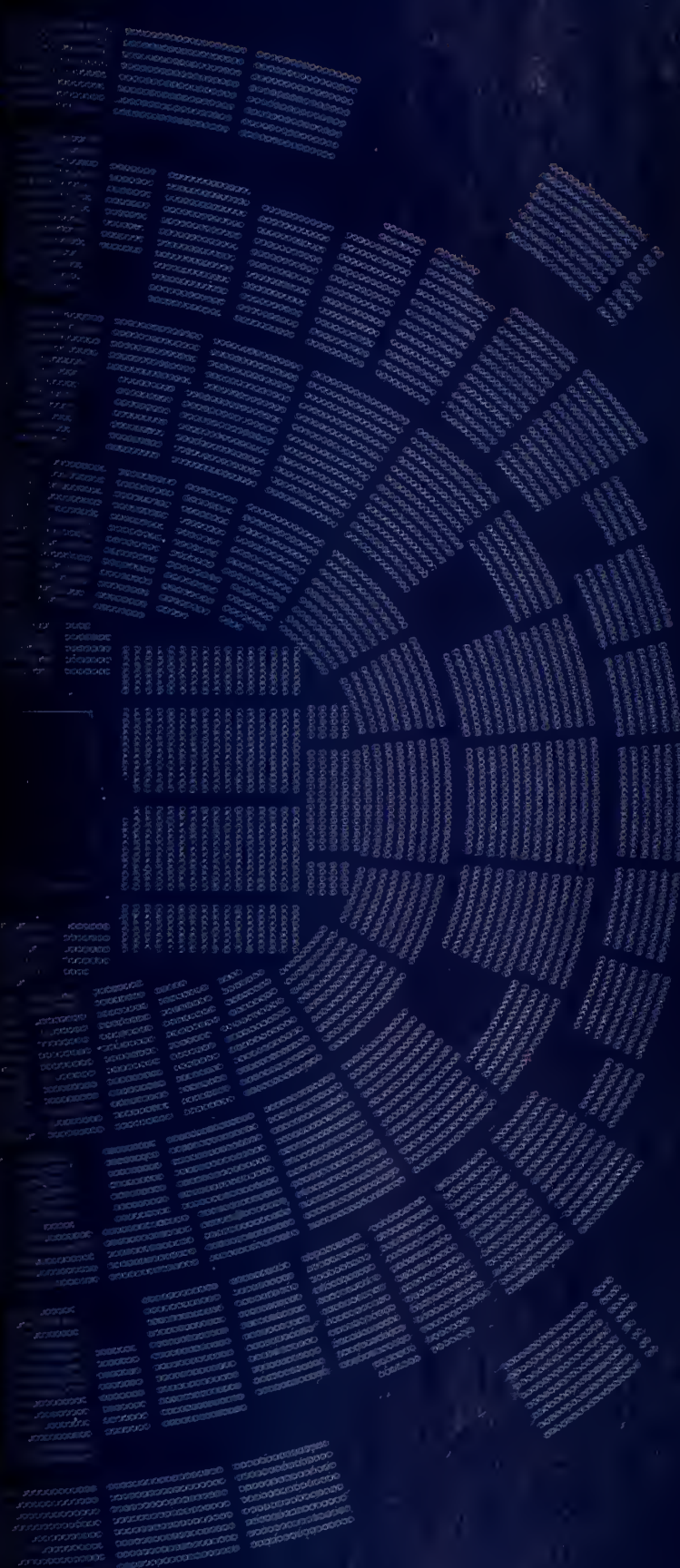
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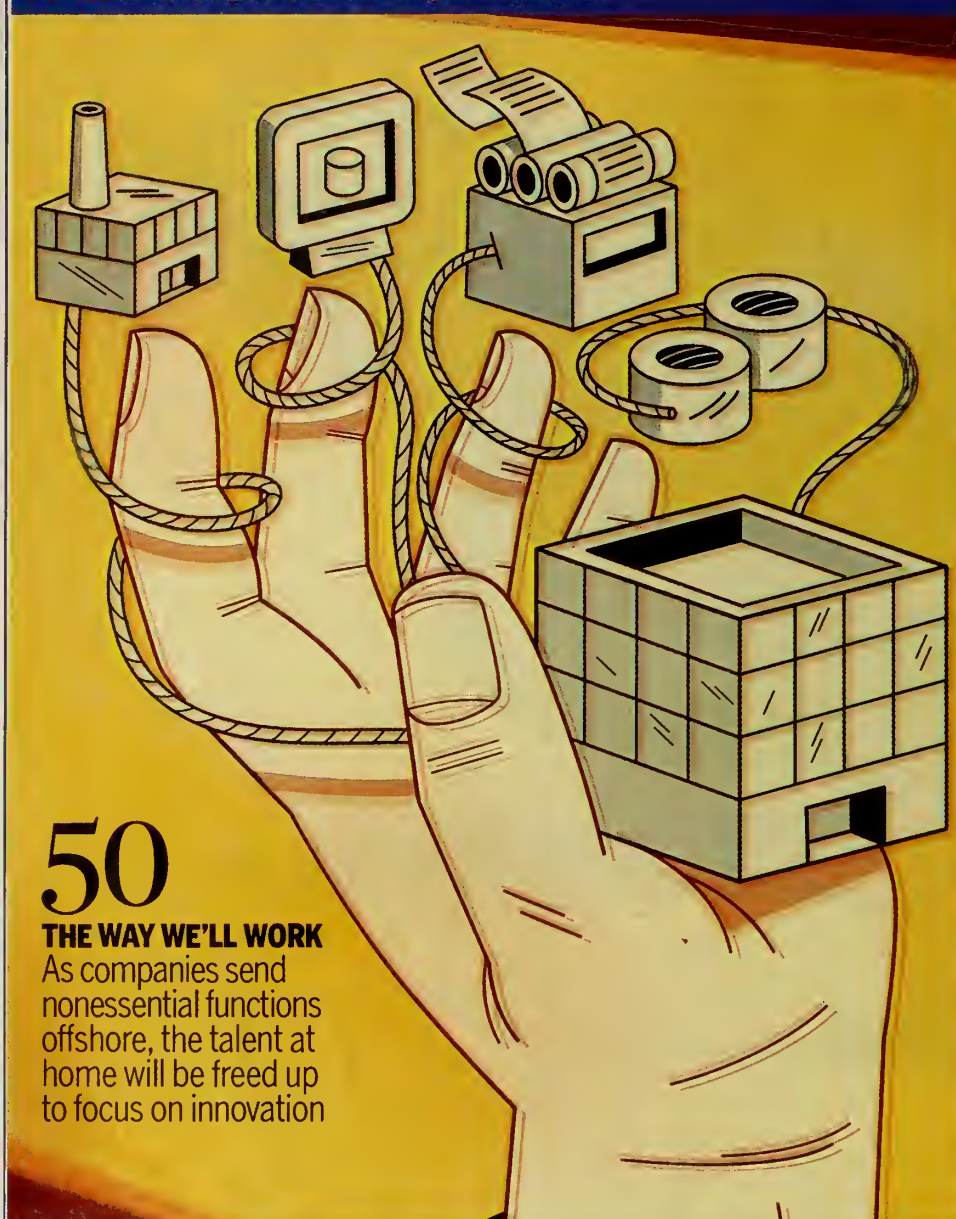
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**The world consumes two barrels
of oil for every barrel discovered.**

So is this something you should be worried about?

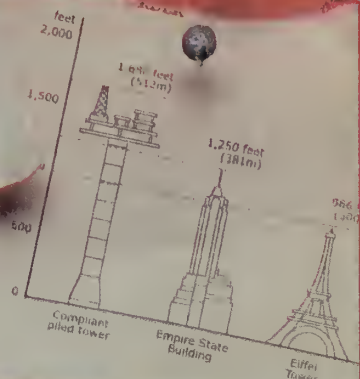
The world consumes 84 million barrels of oil a day.

The fact is, the world has been finding less oil than it's been using for twenty years now. Not only has demand been soaring, but the oil we've been finding is coming from places that are tough to reach. At the same time, more of this newly discovered oil is of the type that requires a greater investment to refine. And because demand for this precious resource will grow, according to some, by over 40% by 2025, fueling the world's growing economic prosperity will take a lot more energy from every possible source.

The energy industry needs to get more from existing fields while continuing to search for new reserves. Automakers must continue to improve fuel efficiency and perfect hybrid vehicles. Technological improvements are needed so that wind, solar and hydrogen can be more viable parts of the energy equation. Governments need to create energy policies that promote economically and environmentally sound development. Consumers must demand, and be willing to pay for, some of these solutions, while practicing conservation efforts of their own.

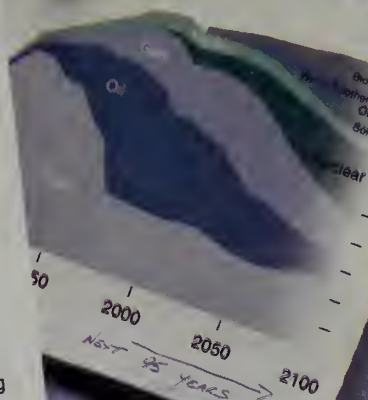
Inaction is not an option. But if everyone works together, we can balance this equation. We're taking some of the steps needed to get started, but we need your help to get the rest of the way.

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By 2030 the number of cars in the world will increase by 50%.

World Energy Demand



Chevron Steps Taken:

Thinking to the future:

- Committing more than \$300 million each year on clean and renewable energies

Finding even more energy today:

- In 2004, achieved exploration record 78% higher than 10-year industry average
- Using steamflooding to extract heavy oil that was previously unrecoverable - more than 1.3 billion barrels from one field alone



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Who's zoomin' who? Tom Veltre gets an angle on a new subject

Second-Act Careers



We're not at Texas Instruments any more: Winemaker Charlton

Given the cycles of economic and labor-market volatility, the last gasp of job security and the growing number of baby boomers who prefer not to quietly retire, **entrepreneurialism** is becoming an attractive choice for many corporate refugees. In this **Online Special Report**, we take a look at why many people are beginning their second act by starting their own businesses. Included are three **slide shows** that offer success stories among three different groups: folks who've been **downsized**, **retirees**, and **women**. Find out how they did it, and what advice they have for others. Another online story examines what it's like to use a **B-school degree** to launch a career as an entrepreneur. We've even included an **interactive quiz** to see if you're ready to go solo. You'll find all these and more online at www.businessweek.com/go/secondacts



Romero recharged himself with a battery franchise

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JP Front

"He lets you run your own shop."

—Business Wire founder Lorry Lokey, to the San Francisco Chronicle, on why he sold his company to Warren Buffett for several hundred million dollars

ED BY DAN BEUCKE

AD AVENUE SEARCH OF ABSOLUT EXTINCTION

LENNY KRAVITZ help
Absolut lure younger drinkers?
It's the hope of Absolut
parent V&S Group of
Stockholm, which is
launching its first
marketing
campaign in 25 years.
In 1979, Absolut
launched the
premium vodka
brand, using stylish
aging and clever ads to
convince consumers to shell out an
average of \$20 a bottle. But
now Absolut is under attack
from more than 100 new vodkas.
One of the U.S. import



market fell from 58% in 1999
to 36.5% in 2004, says Adams
Beverage Group.

The multimillion-dollar
push marks the first time
Absolut has advertised on TV.
The ads by TBWA\Chiat\Day
play off iconic moments that
are "absolutes" in pop culture.
They will debut on cable chan-
nels such as Comedy
Central, E!, and Fox
Sports Net. Absolut also
commissioned rocker
Kravitz to come up with a
dance track (with no
mention of Absolut in the
lyrics) entitled *Breathe*.

It's a free download on
Absolut's Web site. One thing
isn't changing: Absolut will
continue its iconic print ads
starring its bottle dressed up
by fashion designers, artists,
and others. —Kerry Capell



CHARITY CASES

Don Imus Wants You—To Pony Up

DON IMUS HAS A NEW CAUSE, and doesn't Big Business know it. The radio personality (and ex-Marine) has been naming companies he thinks should give to the Intrepid Fallen Heroes Fund. The nonprofit recently began building a training-skills facility in Texas for injured vets of the Iraq and Afghanistan wars. It raised \$27 million, with major donations from **Fisher Brothers**, the **Michael & Susan Dell Foundation**, the **Avon Foundation**, and **Anheuser-Busch** (page 86). But the organization needs \$10 million more to finish construction.

Imus, who gave \$250,000, hasn't been shy about suggesting potential donors, putting the touch on **Halliburton**, **Pfizer**, **Google**, and **ExxonMobil**, among others. On his Jan. 17 show, he said: "I know people who could write the check. Why they don't, I don't know." A Halliburton spokesperson says the company sponsors a number of military-related causes and gets more requests than it can handle. The other businesses declined to comment. Bill White, the fund president, is grateful for the attention. "We worry about the perception of challenging corporations publicly, but I think it's being done in fairness," he says. "Imus has a terrific way of getting the word out." —Elizabeth Woyke

THE BIG PICTURE



PITCHING IN Product
placement ads on network
TV are way up: 22% higher in
2005 than in 2004. Here are
the most active shows:

Product placements, Sept. 19–Dec. 25, 2005

THE RACING RACE: FAMILY EDITION (CBS)	2,037
THE APPRENTICE: MARTHA STEWART (NBC)	1,861
THE APPRENTICE (NBC)	1,839
AMERICA'S NEXT TOP MODEL (UPN)	1,427
THE BIGGEST LOSER (NBC)	1,247
THREE WISHES (NBC)	1,100
EXTREME MAKEOVER: HOME EDITION (ABC)	919

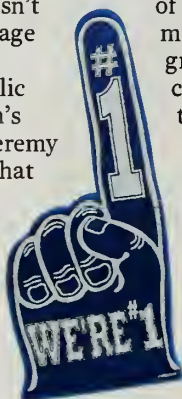
Source: Views, Nielsen Product Placement service

STOCK TALK

TOUGH TIMES FOR LEADERS OF THE PACK

IT'S AXIOMATIC that being No. 1 in a market is a good thing. But research by two consultants at **Marakon Associates** finds that in recent years scale hasn't delivered the advantage you might expect. In analyzing 3,260 public companies, Marakon's Brian Burwell and Jeremy Sicklick discovered that between 1999 and 2004, the median total shareholder return was 1.8% for market leaders vs. 9.5% for non-leaders.

What gives? The results partly reflect the quirks of the economy: Leading airlines, for instance, were hammered



after September 11 in a way that the small fry, including discounters, were not. Also, Burwell points out, companies that bulked up through mergers and acquisitions in the 1980s and '90s could exploit gains in productivity, but those gains have slowed in the past five years. Finally, the increasing segmentation of the consumer marketplace has made growth tougher to come by for companies trying to appeal to broad swaths of buyers. "Serving large numbers of customers is less of an advantage today than it was 10 years ago," says Burwell.

It all adds up to an intriguing lesson. Whether it will be heard above the fee-driven clamor for a new round of mergers is another matter.

—Brian Hindo



MOVE OVER, SACAGAWEA

FANS OF THE Sacagawea dollar are riled up over a plan to augment it with new coins recognizing 37 ex-Presidents. To avoid flooding the market, Sacagawea's production will drop by two-thirds when the Presidents roll out in 2007. In 2000, the Sacagawea dollar marked the first such recognition of a Native American woman. But today the coins are so scarce you need a vending machine to find one. "Sacagawea contributed something very special to our history," says Senator Mike Enzi (R-Wyo.). "I don't want to let a reminder of [that]." But he's fighting cold cash. The Treasury expects the Presidents, which it will sell to the Fed at an 80% margin, to be hugely profitable.

—Bremen L.

BLOGSPOTTING

BEING A MILLIONAIRE AIN'T WHAT IT USED TO BE

2million.blogspot.com

» **WHY READ IT** To keep tabs on how this 29-year-old IBM engineer in Raleigh, N.C., is balancing his budget in an attempt to reach \$2 million net worth. (He's up to \$206,990.)

» **NOTABLE POST** On buying car parts to bring them to a mechanic: "I then called the dealer and got an estimate of \$380 to change out my starter. Someone recommended I also call a local tire shop... they gave me an estimate of \$303.76. Better, but I checked with Advance Auto Parts... and knew I could get a re-manufactured starter for \$88.21 (after tax)."

DRAWN & QUARTERED



STAHLER.

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10 am. Who let the data out of the bag?

You just forwarded everyone's salary to the whole company.

Did not.

Did too.

Meanwhile, throughout the office...

Did too.

The WE CAN'T GET A GRIP ON OUR DATA era is over.

Microsoft® Office has evolved. Have you? After all, the way we work has changed. Today, information is simply everywhere. Once it leaves your hands, anything can happen. That's why the latest version of Microsoft Office includes Information Rights Management technologies. Now you can put limits on the printing, copying, or forwarding of sensitive e-mail and documents. It's time to evolve the way you work. Discover how at microsoft.com/office/evolve

I think it's time to upgrade our Office 2000.

I'm down with that.

Microsoft®
Office

SOOTHSAYERS



WHAT'S WORRYING BANKERS

Economists are debating whether the economy will slow in 2006. But bankers have already made up their minds. It's not a pretty picture. In an annual survey released by accounting firm Grant Thornton, **65% of bankers surveyed nationwide said they are pessimistic or neutral on the outlook for this year.** That's sharply up from last year, when only 31% were similarly dour or neutral. Of the 334 bankers surveyed through mid-November, most from smaller institutions, 21% are outright pessimists, vs. only 3% last year. An economic slowdown "is a looming specter," warns Jan Miller, CEO of Boston's Wainwright Bank & Trust and one of those surveyed.

What makes bankers downbeat are things like the impact of last year's hurricanes, which bid up building material costs; jitters over Fed Chairman Alan Greenspan's Jan. 31 retirement; and an end to the housing boom. Optimists, on the other hand, expect incoming Fed head Ben Bernanke to do just fine. It helps that most don't think their local housing prices are excessive. —Abed Moiduddin

PIGSKIN CHIC SUPER GUESTS FOR THE SUPER BOWL

SOME OF THE BIGGEST National Football League stars will be playing with their helmets off at Super Bowl XL in Detroit. Former football heroes will command up to \$75,000 for an appearance at corporate parties leading up to the Feb. 5 game, says Robert Tuchman, founder of New York-based marketer **TSE Sports & Entertainment**. TSE is cutting deals for about 25 Super Bowl events.

Top-dollar attractions include Super Bowl MVPs Joe Montana (above), John Elway, and Terry Bradshaw, Tuchman says. Prices are less stratospheric for gridiron personalities who have been out of the limelight for years or who didn't play a glamour position. Archie Manning, a quarterback in the '70s and '80s for the New Orleans



Saints (and whose sons Peyton and Eli were knocked out of the playoffs this year), says he is getting \$15,000 to \$20,000 for a one-hour gig. Ickey Woods, semi-famous for his end zone dance, the Ickey Shuffle, has done events for \$2,000, Tuchman notes.

Duties aren't too strenuous, usually including brief remarks about the big game.

For years, Manning was t attraction in a pre-Super B flag football game put on n **B.F. Goodrich** for its star employees. That ended, Manning says, when the company separated his shoulder. "It got kind of dangerous," the ex-quarter-back says. Goodrich spokesman was unable to confirm the inju

—Mark H.

REWIND

E-GOLD: LOSING MORE SHINE

GOLD & SILVER RESERVE'S tangle with the U.S. government is deepening. The company operates a bullion-backed "digital currency" unit called e-gold that U.S. law enforcement officials say has become a popular payment system for online criminals ("Gold Rush," Jan. 9). On Dec. 16, agents from the **U.S. Secret Service** and **FBI** raided Gold & Silver Reserve's offices in Melbourne, Fla., and took copies of documents and computer files. Now the U.S. **Justice Dept.** is demanding that the company forfeit more than \$800,000 in two of its bank accounts. The funds were seized on Dec. 15 by the Secret Service, which declined to comment, citing ongoing investigations being conducted with the FBI.

The government alleges in a lawsuit filed on Dec. 30 in federal court in Washington that Gold & Silver Reserve—using the name **Omnipay** to provide an exchange service that enables users to

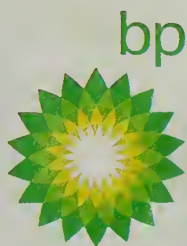


He has denied wrongdoing and said agents exaggerated how much criminals employ e-gold. On Jan. 12, Gold & Silver Reserve filed a motion with the court seeking to reclaim the funds because it does not meet the legal definition of a money-transmitting business. A government response is due by Jan. 30.

Law enforcement officials worry that digital currency is becoming the money-laundering machine of choice for cybercriminals. At least a dozen such services allow users to deposit and transfer funds. Eight, including e-gold, claim to be backed by actual bullion. —Bria Brown

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Welcoming the Welches

No nonsense. That's what you expect from Jack Welch, and that's what you'll get in a new column, "The Welch Way" (page 120), that starts this week. Written with his wife, Suzy the column will deliver blunt, get-it-done answers to questions posed by readers about leadership, competition, and

careers. I can't think of a better duo to serve up smart, pragmatic advice to businesspeople.

In fact, that's what they've been doing since Jack retired in 2001 as chairman and CEO of General Electric. He and Suzy have spoken to more than 300,000 people around the world in groups large and small. As one of the most influential leaders in business history, Jack will draw on his 40 years of experience at GE. Suzy, the former editor-in-chief of *Harvard Business Review*, will bring her own distinctive point of view to the column.

"The Welch Way" will run every other week, alternating with "Face Time with Maria Bartiromo." We're delighted to welcome Jack and Suzy as regular columnists. Please e-mail your questions to thewelchway@businessweek.com.

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SUZY AND JACK Smart advice every other week

the World Economic Forum (WEF) that begins on Jan. 18 in Switzerland.

With so much U.S., European, and Japanese manufacturing already being outsourced, the frontiers of global competition are innovation, creativity, and design. In this second phase of outsourcing, we're seeing fresh approaches that are transforming industries and even creating jobs in the West. Our Cover Story, "The Future of Outsourcing," discusses these important changes and their impact on companies worldwide.

We understand from WEF officials that our Aug. 1 Cover Story, "Get Creative!," played a key role in shaping the Davos program. Reprints of "Get Creative!" and the current issue will be distributed at the WEF. They'll be hot items.

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ReadersReport

MARKETING SAVVY READY INSIDE INTEL

IS RATHER SIMPLISTIC to view Intel as a traditional engineering company that has now become a marketing company "inside Intel," Cover Story, Jan. 9). As R. F. Drucker reminds us, innovation and marketing are the necessary elements for growth. We know what happened, for example, to Hewlett-Packard, and earlier Compaq, when they strayed from their engineering roots. Intel has always been in both areas. The "Intel Inside" effort, for example, branded successfully something that no one ever sees and very hard to comprehend. The legacy of Andrew S. Grove is to always look for high-valued products and to make sure they are marketed as such. There is no reason to believe that a change in its leadership's background will change that basic strategic element, or to think that Intel will not prosper in the future.

—Zino Vogiatzis
Timonium, Md.

CASE FOR ACTIVE PORTFOLIO MANAGEMENT

AS STOCK ANALYST at an "active" asset-management firm, I found "Should Dow ditch General Motors?" (News Analysis & Commentary, Jan. 9), on the merits of GM's remaining in the Dow as an industrial average, a great boost for the cause of active portfolio management. Maybe some of those Diamond Trust ETF investors should come across to the "all-generation" side—the fees are quite competitive these days. Surely it's better to own stocks based on fundamentals, rather than those chosen by *The Wall Street Journal* editors?

—Tim Canham
Sydney

REDUCING THE LIKELIHOOD OF 'JUNK PATENTS'

THE "PATENT EPIDEMIC" Legal Affairs, Jan. 9) indirectly referenced a recent ruling by the Patent Office regarding a patent application. My invention is a high-tech use of money to eliminate competition among business firms. Since my invention does not use a high-tech computer, the patent office viewed it as a low-tech invention, rather than a high-tech invention. In *Ex parte Lundgren*, the patent board correctly ruled that there is no patentable "technological arts" requirement for a patentable invention. Even after this ruling, a patentable invention must still be a useful thing or a useful activity of some kind, not simply an abstract idea. My response to a public outcry that began a few years ago over the patenting

of seemingly obvious business methods (for example, one-click purchasing), the Patent Office instituted the practice of two-level review of all business-method inventions. In addition, the Patent Office has improved its business-related databases. For these reasons, a "junk patent" on an obvious business method is less likely to be issued today.

—Carl Lundgren
Economist and President
Relpromax Antitrust Inc.
Arlington, Va.

CHINA'S B-SCHOOLS: 'GIVING AWAY OUR COMPETITIVE ADVANTAGE'

I READ YOUR RECENT "China's B-school boom" (Global Business, Jan. 9) with alarm and concern. There is a tremendous difference between providing high-quality education to students in the U.S. and offering the same services to foreign competitors in India or China. These two large countries and several technically sophisticated European/ex-Soviet countries potentially could have a permanent and very unfavorable impact on the lives and fortunes of many workers in the U.S.

—Jerry Davison
Fayetteville, Ark.

CORRECTIONS & CLARIFICATIONS

In "Eager eyes on Anadarko?" (Inside Wall Street, Jan. 16), ConocoPhillips, not Chevron, paid \$18 a barrel for Burlington Northern's reserves.

In "Year of Citi in China?" (Global Business, Jan. 23) the first name of Robert Morse, managing director and chief executive of Citi's Asia Pacific Corporate & Investment Bank, was incorrectly identified.

"Sneaker envy" (Up Front, Jan. 16) incorrectly stated that fans persuaded ASICS to produce the Onitsuka Tiger sneakers specially made for *Kill Bill* Vol. 1. On its own, ASICS released a limited run of sneakers to coincide with the film's release. After the shoes sold out, fans asked ASICS to produce more, but it declined to do so.

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"THE
JAPANESE AND
THE FRENCH
ARE SO
DIFFERENT.
HOW CAN
THEY POSSIBLY
FIND A
COMMON
GROUND?"

Toyota's
Vice Chairman
Fujio Cho says
Toyota is enjoying
great success in
fusing its business
methods with
French values.



Technology&You

BY STEPHEN H. WILDSTROM

The Easiest, Smartest GPS Yet

The web of parkways in Westchester County provides a great way to get around New York's northern suburbs, provided you're familiar with the twisty and sometimes poorly marked roads. They're quite a tangle, but I cruised them without trouble on a recent visit because I had the Garmin nüvi 350 onboard, which was almost as good as being a local.

The name makes the nüvi sound like a coffee table from Ikea. But the \$900 device is actually an excellent example of a new breed of navigation product that uses global positioning system satellite signals and a vast database of maps to help you find your way anywhere in the United States (or, with the otherwise identical nüvi 300, anywhere in Europe). About the size of a deck of cards, it attaches to your windshield via a suction-cup mount. Its big, bright screen and clearly spoken driving instructions make it a pleasure to use.

Stand-alone GPS systems you install in your own car have been around for several years, but earlier generations suffered from three problems: The units, which calculate your position using tiny differences in the length of time satellite signals take to reach a receiver in your car, were slow. If you got off an airplane and fired up your receiver in a rental car, it could take a couple of minutes for the system to find your position—a great inconvenience if you were rushing to get to a meeting.

The older units also lacked the processing power needed to calculate routes quickly. If you missed a turn or deliberately deviated from the instructions for some reason, you got no help while your GPS system recalculated the route. And limited storage meant you had to load maps from a PC when you were traveling to different parts of the country.

THE NÜVI IS DIFFERENT. Even starting from a “cold fix,” which occurs when you first turn it on in a new location after traveling with it turned off, the device will generally find its position in under a minute. If you turn the nüvi on without having moved far from its previous location, a fix is nearly instantaneous.

Once you've punched in your destination and the nüvi has selected a route, the device automatically adjusts its map display to an appropriate view, covering a wide area while you are zipping along the highway and zooming in as you approach a turn. You can also adjust the view manually by tapping “+” or “-” icons on the display. Turn instructions are displayed both on the screen and spoken by a female voice that seems to be shared with every voice-mail system. It



**GARMIN'S
NÜVI
NAVIGATION
SYSTEM**

strikes a good balance by giving you plenty of warning of maneuvers with becoming a nag. Within seconds of missing a scheduled turn, the voice announces that it is calculating a new route and quickly offers new instructions.

When popped off its windshield mount, the nüvi can slip into your pocket. If you add a memory card, it can do as an MP3 player or play audiobooks from Audible.com, though it's no better than mediocre at those tasks. Much better is the optional (\$75) multi-language phrase-book, which both displays and speaks translations.

The nüvi is a strong performer in an increasingly competitive field. Less pricey choices from Garmin include the \$500 i55, which has a smaller display, despite being bulkier overall. It lacks the nüvi's nonnavigation features. For \$100 less, the GO 300 has similar features, but you have to download the maps from a PC.

The GO 300 from TomTom and the Mio 269 (both around \$550) are somewhat larger than the nüvi but offer similar navigation features. The TomTom also is equipped with Bluetooth wireless and can serve as a hands-free adapter for a variety of cell phones.

Seconds after you miss a turn, a voice offers revised instructions

When I bought my car a while back, I decided to forgo the \$2,000 navigation system because at least 90% of the time I drive in places where I don't need help. And it couldn't give me a hand where I need the assistance—driving rental cars in places I don't know well. That's where the nüvi and its competitors can really earn their keep. ■

E-mail: techandyou@businessweek.com

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Toyota's Vice Chairman Fujio Cho says France and Japan make a winning partnership.

Has it been difficult adapting to the French way of doing things?

We have had no difficulty at all. At Toyota, our management philosophy is based on two pillars: mutual respect and what we Japanese call 'Kaizen', which means continuous improvement. We actively encourage our employees to suggest new ways that can improve our system. Because inventiveness comes naturally to the French, we've had no difficulty adapting the spirit of Kaizen to France. In fact, the employees at our factory in Valenciennes have developed a new technical vocabulary that fuses Japanese with French words. I think this is a good example of how we've achieved a good blend of French thinking and work styles with the core values of the Toyota Production System. It is thanks to the French people that our French business is so successful.

So what has French innovation brought to Toyota?

Our strategy is to manufacture vehicles where the market is. That means designing models that meet the high demands and tastes of European consumers. We chose to set up a design center in the south of France with a mission to develop cars that precisely fit the European market. Our design center in southern France has created the styling for key models like the Yaris (sold as the Vitz in Japan) and Corolla. In fact, the Yaris has won high acclaim not only in Europe, but also in many other markets around the world.

Are the French hard to work with?

The people of the Nord-Pas-de-Calais region where we built our plant have demonstrated outstanding teamwork and a Kaizen attitude that got production up to speed very smoothly. Our star-shaped factory, which was state-of-the-art when we built it in 1998, became operative very quickly; the result of the local people's tradition of high-level skills and workmanship which combined beautifully with the Toyota Production System.

Toyota in France

- In France since 1971 with 5 business units covering all the value chain
- At Toyota's main plant on the European continent, in Valenciennes, 3,200 employees work round-the-clock producing 210,000 cars a year
- Toyota's studio in Sophia-Antipolis has designed two of their best selling cars

such as the stages of bringing plants on line and work procedures, but we overcame these. Our mutual strengths and weaknesses complement each other, and have created a good cooperative relationship for the future. It gives me great pleasure to know that we have been able to launch the Aygo, a car developed for the European market, as a concrete result of this partnership.

What do you find attractive about doing business in France?

France has a highly developed automotive industry and is an extremely important nation in Toyota's European strategy. It has a rich industrial infrastructure, numerous parts suppliers and a highly qualified workforce. And it is geographically in the center of Europe with a high quality transport infrastructure.

Has your joint venture with PSA Peugeot Citroen been a productive experience?

It has been a very challenging experience, in which both Japan and France have learned much from one another. There were differences in areas



"We've had fantastic support from the French. Great teamwork and a real understanding of the concept of 'continuous improvement'."

What has the Government done to help?

When we built the plant in 1998 the Government assigned a single dedicated person to handle all our negotiations. This streamlines decision making so that everything happens as quickly as possible. The French Government has been a huge help.

Toyota is the only Japanese car firm to manufacture in France. Haven't you ever felt any difficulty doing business here?

Absolutely not. After starting out in France as an importer, we've gone on to become an investor and now a full-scale industrial player. We design, engineer, manufacture and sell our cars here. We even have our own showroom on the Champs-Élysées.

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AOL: MySpace Invader

Did you think MySpace could blow up this big, this fast without anyone else noticing? Time Warner's AOL is readying its bid for the MySpace.com, space. ¶ It won't be a site per se. Rather, the online giant is building a platform off its massively popular AOL Instant Messenger service to better enable its users to share and create content. That the internal shorthand

for the project is "AIMspace"—don't count on that being its real name—testifies to how tightly the company plans to tie it to AIM, which the company says has 43 million users. (What is an IMer's "buddy list" if not a social network?) It also shows how MySpace has become the generic term for all social networking sites, which were the dark-horse mass media success story of 2005.

Executives with firsthand knowledge of AOL's internal discussions say the platform's features won't arrive all at once, but the first ones likely will surface in March. It's expected to blend all manner of AOL content offerings with the user-created content, conversation, and community that define social-networking sites. As with MySpace, expect music to play a major role in AOL's effort; it's an area in which AOL already boasts bona fides. While traffic at AOL Music has slipped slightly, thanks to growth at Yahoo! Music and Apple Computer's iTunes, the site nonetheless notched more than 17 million unique visitors in December, according to comScore Networks. An AOL spokeswoman declined to comment on any specifics beyond an e-mail saying "it's just too premature for us to talk about our social networking plans today."

IF YOU NEEDED ANOTHER milemarker to measure today's landscape, consider some MySpace data. Last month the site, which just entered its terrible twos, had 32.2 million unique visitors, more than quadrupling the comparable total for 2004. Earlier this month, Rupert Murdoch said MySpace was adding 1 million new members a week. (How hard is Viacom kicking itself for getting outbid by Murdoch's News Corp. for the site last summer?) Thus there's a vogue for anything smacking of a social network. In recent months, Yahoo purchased photo-sharing site Flickr.com, social calendar site Upcoming.org, and del.icio.us, a tagging service that allows users to share bookmarks.

Eye-popping traffic numbers rung up by MySpace, facebook.com, and xanga.com, and those brands' meteoric



rise, make it easy to forget just how devalued the phrase "Web community" once was. Not that long ago it was linked to flameouts and never-weres such as TheGlobe.com and Geocities. Back then the notion of reader-produced content was, often correctly, interpreted as "are too cheap to pay for it." That mill of consumers, and especially young ones, now find online pals' content—be it photos, messages, or random musings—more compelling than that of quote-unquote professionals is one of the bitterest pills Big Media has had to swallow of late.

Launching a social network off its instant messenger

Despite its New Media Day, AOL is as Big Media as online players come—that is, it's an established mass-market brand, not especially renowned for taking. Its massive user base, the popularity of AIM and a gear geared to music and games suggest AOL could be the one Big Media player to create, rather than buy, its own social network. But social network

thrive on a sort of chaos that's anathema to AOL, and the ways in which AOL seeks to tame the wilder aspects of Web are at odds with MySpace's loose vibe. (That MySpace is a big online hook-up joint doesn't always register in press accounts.)

The years when AOL's revenue was goosed by hourly racked up by adults at play in its minutely segmented chat rooms are long gone, and though it used to be good at lighting a fuse and getting away, it's uncertain if AOL can back. But AOL is trying to play in the upside-down world of today's media. Murdoch wants to make MySpace more like a portal. And the portals want to be more like MySpace. ■

BusinessWeek online

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The Barker Portfolio

BY ROBERT BARKER

Guidant or No, J&J Is a Buy

To Wall Street, Johnson & Johnson has been sounding like Dumb & Dumber. In the past year, the health-care giant has gone from nearly grabbing Guidant in a friendly merger to blundering into a bidding war for the cardiac-device maker with rival Boston Scientific. Whoever wins Guidant, I just hope J&J ends up looking D, D, & D.

Dumb, Dumber, & Dumbest, I mean. The reason is simply that I want to buy the stock, and I'm hoping the Street's hot-money pros keep pounding it into a better bargain. Trading lately below 62, J&J is already cheap, less than 17 times this year's estimated earnings, according to Capital IQ, a data unit of Standard & Poor's. That's down from highs last spring near 70. It may get cheaper yet. Morningstar analyst Tom D'Amore puts J&J's intrinsic value at 76, but that was before the company began raising its bid for Guidant to fend off Boston Scientific. If J&J ultimately pays up for Guidant, D'Amore figures he will cut his estimate of its value, maybe to 72. "Guidant has so many problems with quality control," D'Amore told me. "It's going to wind up being a major distraction for Johnson & Johnson, even though the growth in the [implantable cardiac] devices market is so attractive."

Fair enough. But for patient investors, any opportunity to buy J&J when it's out of favor is one to grab. Do I know that a merger with Guidant won't come too expensively? No. Do I know that absorbing Guidant won't prove distracting to J&J management? No, and I'm sure that the 13 months J&J has spent trying to lock up Guidant have taken a toll. But here's the thing: In the context of J&J's overall operation, Guidant is far from a make-or-break deal. Analysts expect Guidant to take in a bit less than \$4 billion in revenue this year, or about 7% of J&J's expected sales.

THAT \$55 BILLION IN TOTAL SALES WILL BE flowing to J&J's New Brunswick (N.J.) headquarters from one of global capitalism's most powerful collection of products and

businesses. These include the familiar baby-care shampoos and lotions, over-the-counter medicines such as Tylenol, a bunch of prescription drugs, including schizophrenia medication Risperdal, plus increasing numbers of medical tools and devices, notably cardiac stents, a market where it competes fiercely with Boston Scientific. While pharmaceuticals had been contributing an outsize share of operating profit, medical devices now are chipping in a bigger portion: nearly 39% through last year's first three quarters, up from 31% in the comparable year-earlier period. (One dolorous source of growth: surgical cutting tools for bariatric operations on the obese.) When J&J reports its full 2005 earnings on Jan. 24, it's expected to post revenue growth of about 8%, to \$51 billion. Net earnings are seen nearing \$11 billion, up from \$8.5 billion the previous year.

If you ask me, those earnings are underappreciated by the market, because every investor fully takes into account the company's financial impregnability. A triple-A borrower in the view of S&P, J&J at last report had \$15.2 billion in cash and short-term investments against just \$2.4 billion in total debt; earnings covered fixed charges more

than 32 times over. J&J's operating cash flow, \$11.2 billion in the past four quarters, is so strong that, after

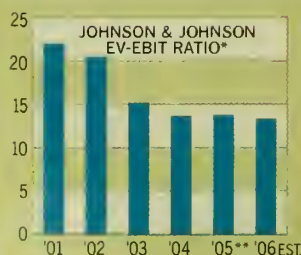
subtracting capital spending, acquisitions and stock repurchases, along with \$3.7 billion in dividend payments, it still had almost \$5 billion left over.

Even as operating cash flow has grown in 2001 it came to \$8.9 billion—the market has been steadily knocking down J&J's value, as measured by the ratio of its total enterprise value (that is, net debt plus equity value) to earnings before interest taxes (chart). Now, with the uncertainty over the Guidant deal helping to obscure company's fundamental strengths, there looms an opportunity for investors to buy a share of J&J's cash flow even more cheap. If J&J winds up with Guidant, I hope the market reacts badly and pushes the share price under 60. At that, J&J would be paying a 2.2% dividend yield, compensation enough for me until the pros on the Street get smarter or at least smarter. ■

E-mail: rb@businessweek.com



NO MORE TEARS?



*RATIO OF ENTERPRISE VALUE TO EARNINGS BEFORE INTEREST AND TAXES, ANNUAL AVERAGE
**YEAR TO DATE
Data: Capital IQ

JAMES C. COOPER

Don't Count Consumers Out Just Yet

their spending momentum at yearend will carry over into 2006

U.S. ECONOMY On Jan. 27 the government is scheduled to announce its first estimate of economic growth for last year's fourth quarter. Headlines are bound to blare that the economy grew at its slowest pace in nearly three years and that consumer spending was the weakest in more than a decade. Investors, especially those in the

stock market, will be placing bets on what the data mean for 2006 and how the news might sway Federal Reserve policymakers at their next meeting, only four days later. Economists are already starting to alert the markets. Based on the latest available monthly data that the Bureau of Economic Analysis will use in calculating the headline number for real gross domestic product, the economy most likely grew somewhere in the range of 2% to 3.3% last quarter. Real GDP has not posted a growth rate below 3.3% since the first quarter of 2003. The report will provide grist for the argument that the economy is finally picking up because of soaring energy costs, higher interest rates, and a cooler housing market.

The case will sound compelling because last quarter's growth was led by consumer spending, which appears to have posted little or no growth after gains averaging 1.5% in the prior three quarters. As the reasoning goes, consumer resilience has been the main support for growth, and as consumers fade so will the economy.

LOSE READING of the monthly data, however, shows a different picture. There is little to suggest that consumers are ready to call it quits. If anything, their spending gained momentum through the quarter after a shaky start that was almost solely the result of a drop in car sales from an exceptionally high level that had been exaggerated by generous sales incentives. The numbers show that buying held up firmly everywhere. The government's report on retail sales reflects very good holiday buying, and the current prospects for spending, including rising confidence and solid job markets, suggest that overall outlays in the first quarter will rebound strongly—and so will GDP growth. When the GDP report is released, look beyond the headline numbers. While inflation-adjusted spending on goods and services grew little, if at all, last quarter, purchases of everything excluding autos appear to have advanced at an annual rate of close to 4%. That would be faster than the advance in the third quarter. Consider that sales of cars and light trucks last quarter plunged at an annual rate of nearly 40%. It was the steepest quarterly drop in 16 years, from a 17.9 million unit pace to 15.8 million. Despite the gyrations, auto

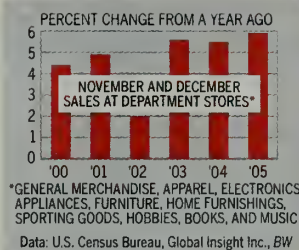
sales in the second half still averaged 16.9 million, the same respectable pace as in the first half.

The latest government data on retail sales illustrate the story. Retail buying last month increased a strong 0.7% from November, boosted by a rebound in car sales. Excluding cars, store totals increased a more modest 0.2%. But retail receipts were unusually volatile in the

second half of last year, reflecting not only the ups and downs in car sales but also the big swings in gasoline prices and building materials caused by the hurricanes in the Southeast.

Excluding those three categories, the remaining 60% of retail sales provide a more stable gauge. That core measure of buying rose at an

THIS MEASURE SHOWS STRONG HOLIDAY SALES



annual rate of 7.3% in the fourth quarter, faster than the 5.2% pace in the third quarter.

THERE HAS BEEN MUCH HAND-WRINGING over the strength of holiday spending, but the government's retail figures allay those concerns. Looking only at sales at department stores, which correlate with holiday buying, and measuring from previous-year sales levels, as retailers do, sales for this grouping in both November and December rose 5.9%. That was the best showing since 1999 (chart).

Spending in these stores makes up about 25% of the retail sales total and includes outlays for general merchandise, apparel, electronics, appliances, furniture, home furnishings, sporting goods, hobbies, books, and music. Moreover, the grouping does not include Internet shopping and mail-order businesses, for which December data are not yet available. In November those sales were up 12.3% from the previous year, and December most likely posted a similarly strong showing.

The momentum in consumer spending should continue into 2006, and January outlays could be quite

strong. For one thing, in the past two years, month-to-month gains in the government's grouping of department-store sales have shown a tendency to be weak in December and stronger in January. That may well reflect the increasing use of gift cards, which are not counted as sales until they are used to buy merchandise or services.

For another, the weather during the first half of January was unusually mild, according to the National Weather Service. That not only facilitated shopping around town and trips to the malls but also meant households got a bit of a break on their winter fuel bills.

One new concern, however, is the recent resurgence in the price of petroleum, which has jumped back to more than \$65 per barrel on fears that Iran will curtail its oil shipments in retaliation for possible U.N. sanctions if it continues with its nuclear energy program. If oil remains at that level, gasoline prices could head back up this spring.

DESPITE THE WEAK-LOOKING overall result for consumer spending last quarter, the GDP report will show that the rest of the economy held up well. That's important for growth early in 2006, because it means that last quarter's slowdown was not broad-based.

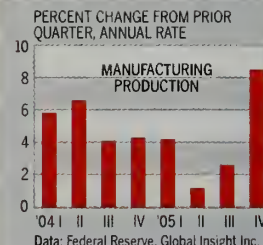
Monthly data show that housing activity, while cooler, made another solid contribution to growth last quarter, and any housing collapse remains unlikely with mortgage rates at only 6.25%. Also, the business sector provided oomph as capital spending continued to advance and as companies began to rebuild inventories

after two quarters of liquidation. The biggest downer was a wider trade deficit, which subtracts from GDP growth.

Perhaps the best sign of the economy's forward thrust comes from the industrial sector, where production and hiring continued to move ahead at yearend. Industrial production in December rose 0.6% from November, as companies used 80.7% of their production capacity, the highest utilization rate in five years.

Manufacturing output was weighed down last quarter by cutbacks in the auto industry. Even so, factory production the quarter grew at an annual rate of 8.5%, the strongest advance in six years (chart). That rise is partly because of a

THE FACTORY SECTOR POWERS AHEAD



bounceback from hurricane-depressed levels in the third quarter. It also reflects big gains in the production of high-tech equipment, which grew at an annual rate of 24% last quarter.

With the economy showing continued momentum outside of consumer spending and with the growth in consumer outlays set to improve markedly this quarter, last quarter's slowdown in GDP growth will not likely be an ill omen for the first half of 2006. Investors betting otherwise could be in for a disappointment. ■

INTEREST RATES

Some Help Ahead from Interest Income

THERE IS HIGH anxiety in the financial markets about rising interest rates. Many analysts fear that consumers will suffer, especially given the recent popularity of adjustable rate mortgages (ARMs). But with short-term interest rates catching up to long rates, most Americans shouldn't feel much pain.

The increase in interest income received by Americans on their assets

in 2005. At the same time, consumers should earn close to \$73 billion more in interest income.

The flattening yield curve is a positive for many consumers. The Federal Reserve has lifted its federal funds rate by 325 basis points, to 4.25%, since June, 2004. But Americans hold far more assets, including savings accounts and certificates of deposit, that are linked

to short-term interest rates than they do liabilities such as credit-card debt. With the Fed expected to raise rates a bit more this year, interest income should accelerate.

At the same time, concerns that the Fed's tightening would punish the historically large

number of homeowners who have opted for ARMs remain premature. In 2006 nearly \$320 billion of about \$2 trillion in outstanding single-family ARM loans are set to readjust. If the entire \$320 billion were refinanced into fixed-rate mortgages—a fair assumption with the recent reset at 7%, vs. 6.25% for a fixed-rate mortgage—annual interest costs would rise by \$4.75 billion, the Morgan economists calculate. But none of the ARMs set to float this year were refinanced, net interest income would still be positive.

This year's gains in interest income are coming at an important time. The positive change in net interest will provide consumers with some additional funds to fuel spending just as the housing market, the most recent engine of consumer spending growth, is expected to wind down. ■

—By James Mehring in New York

THE SILVER LINING OF HIGHER RATES

CHANGE IN HOUSEHOLD INTEREST PAYMENTS AND INCOME

BILLIONS	2004	2005*	2006**
INTEREST PAYMENTS	62.1	80.9	65.1
INTEREST INCOME	-4.9	63.3	72.8
NET INTEREST	-67.0	-17.6	7.7

*Estimate **Forecast

Data: JPMorgan Chase & Co.

According to JPMorgan Chase economists Robert Mellman and Bruce Kasman, higher rates should translate into \$65 billion more in interest payments on all forms of debt in 2006 compared with



60% of Japanese computer games
are designed in North England.

Game on.

It's not easy to impress the Japanese. Their exacting standards mean only a limited number of companies actually make the grade. So it's quite an accolade for North England to achieve such a high percentage, particularly as most of these games are worldwide best sellers. Expertise in technology and electronics isn't limited simply to computer games. From online gambling software to intelligent applications for mobile phones and Wi Fi telecoms, U.S. companies are extensively utilizing the region's specialist skills, so it's no coincidence that the top global electronics companies have their headquarters in North England. To date, over 1200 American companies here, have moved up to the next level. Ready to play? Visit www.northengland.com



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EDITED BY HARRY MAURER



Tepid Tech Show us the money. So said Wall Street to tech companies after **Intel** and **Yahoo!**, bellwethers of the PC and Internet advertising segments, reported profits on Jan. 17 that sank below Street expectations. Intel (**CEO Paul Otellini**, photo) blamed its blues on a supply shortage of chipsets needed for its desktop PCs, while Yahoo cited steeper operating expenses and less-than-stellar ad growth. On Jan. 18, Apple and eBay weighed in with so-so forecasts.

Even though other tech titans, such as **IBM** and **EMC**, posted solid results, disillusionment prompted a slew of downgrades as analysts ran new numbers for their growth projections. No one expects the bottom to fall out, but investors may do well to stay wary, given the problems likely to plague techdom this year as communications, computing, and consumer electronics makers clash.

See "Intel's supply stumble," www.businessweek.com/go/tbw

Two Bidding Wars Remember King Pyrrhus? Twenty-three centuries ago he beat the Romans in battle, but at such a cost that his army lost the war. As bidding goes stratospheric for **Guidant** and **Dofasco**, the winners could end up with Pyrrhic victories of their own. Topping **Johnson & Johnson** once again, **Boston Scientific** on Jan. 17 said it'll pay \$27 billion for Guidant despite falling sales and earnings at the medical-implant outfit. Meantime, Luxembourg's **Arcelor** on Jan. 16 upped its offer for Canadian steelmaker Dofasco to nearly \$5 billion, grabbing the lead from **ThyssenKrupp** of Germany. Share prices of both leading bidders fell amid worries that they're overpaying.

See "Guidant or no, J&J is a buy," page 26, and "Is the battle for Guidant 'irrational'?" www.businessweek.com/go/tbw

The Aerospace Race Airbus came on strong in a stretch, confounding the experts by finishing ahead of Boeing in passenger aircraft orders for the fifth year running, 1,055 to 1,002. But look closer: Boeing sold 154 widebodies to just 15 competing A340s, and widebodies booked much wider margins. For now, both planemakers are soaring on record sales.

See "Why Airbus can't glide on 2007," www.businessweek.com/go/tbw

AIG May Settle So far, no one's charged with stealing. Former **CEO Hank Greenberg** got the boot and, months later, **American International Group** remains strong. But AIG's account shenanigans could bring some of the largest fines in corporate history. The insurance giant may pay up to \$1.5 billion to settle federal and state civil investigations, said insiders Jan. 13. Who's furious at the reports? Greenberg, who asserts that **New York State Attorney General Eliot Spitzer**, a candidate for governor, is on the warpath against AIG for political gain. AIG declined comment; the stock barely budged.

A Bronx Cheer for Tyco Take your breakup and Well, maybe Wall Street's reaction to Tyco's plan, announced on Jan. 13, wasn't quite that violent, but almost. Shares tumbled 11% the day **CEO Edward Breen** unveiled a complex scheme to split the \$40 billion conglomerate into three pieces, and were down 13% by Jan. 18. One reason: While the breakup will take at least a year to complete, Tyco's earnings engine has blown a piston.

See "The trouble with Tyco," www.businessweek.com/go/tbw

Maryland vs. Wal-Mart When a state passes a law aimed at the health coverage of one company, it's not tough to guess what company that might be. On Jan. 12, Maryland legislature, over the veto of **Republican Governor Robert Erlich**, approved a bill that will force Wal-Mart, which employs 17,000 in the state, to spend at least \$8 million on health insurance for those workers or into an insurance fund for the poor. Unions and activist groups are pushing similar legislation for all large employers in at least three dozen states, but most of those bills are likely to sicken and die.

See "First Wal-Mart. Then what?" www.businessweek.com/go/tbw

Drug Plan, Heal Thyself Another migraine for the **Administration**: Hundreds of thousands of mostly poor seniors who signed up for its **Medicare** drug plan had trouble getting their meds in the chaotic two weeks after it took effect on Jan. 1. Officials are boosting Web and phone assistance, so that when pharmacists check to see if a patient is enrolled, they'll be more likely to get an answer. The fed also telling insurers to reimburse states that ponied up when seniors were turned away because they couldn't find a doctor in the plan. Washington says clients should leave drugstores until they get what they came for.

See "Plan A: Hook them with Part D," page 26

ing Aim at VNU From hunter to hunted in three months. That's the apparent fate of Dutch media group VNU, owner of market research outfit **ACNielsen** and target of a Jan. 16 takeover bid from a private equity consortium including **Blackstone Group**, **Carlyle Group**, and **Berg Kravis Roberts**. (Just a day later, VNU said it was buying a majority stake in Web research firm **BuzzMetrics**.) VNU's penchant for audacious deals got it in trouble last month, when shareholder pressure led to the resignation of **CEO Rob van den Bergh**. The consortium's \$8.8 billion bid looks stingy, but for now there's no other bidder.

New United Airlines Parked in Chapter 11 for 37 months, United is taxiing toward a Feb. 1 takeoff. But despite huge cutbacks—it got rid of nearly 25,000 employees in one in three, and dumped its pensions—it's unclear whether it can gain altitude. United began presenting its reorganization plan on Jan. 18 for final approval. All parties had signed off, though workers were still grumping about the deal management made for itself. **CEO Glenn T. Hubbard**, for example, will get at least \$15 million in stock. The airline says it should be profitable this year but pegs its price to \$50-a-barrel oil. Crude closed near \$66 on Jan. 18.

Google Turns to Radio Continuing a thrust to extend its empire beyond the Web, the search king on Jan. 17 bought radio-advertising outfit **dMarc Broadcasting** for a sum that could range from \$102 million to \$1.2 billion, depending on dMarc's performance over three years. Google stock rose 1% on Jan. 18, largely because of broader tech jitters.

See "Google: Searching for an edge in ads," page 80, and "S&P downgrades Google to sell," www.businessweek.com/go/tbw

Collapse of the Week

In conformist Japan, the nail that sticks out often takes a pounding. Latest case: **Takafumi Horie**, Netpreneur and founder of portal **Livedoor**. Six months ago the business press was lionizing Horie as an iconoclast. He was even recruited by **Prime Minister Junichiro Koizumi** to run for a Diet seat. (Horie lost big.) Now, Livedoor is under investigation for allegedly doctoring its earnings and its accounting. A flood of sell orders crushed Livedoor's stock and prompted the **Tokyo Stock Exchange** to halt trading early on Jan. 18 for the first time ever—but not before the **Nikkei** lost nearly 7% in three days as other key Japanese Net plays, such as **Yahoo Japan**, **Stbanc**, and **Rakuten**, Japan's biggest online retailer, also went into free fall. Horie and Livedoor officials deny the charges and say they will cooperate. But Horie probably won't be getting face time with Koizumi anytime soon.

See "High drama on the Tokyo exchange," www.businessweek.com/go/tbw



TAKAFUMI HORIE



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MARKETS

HEDGE FUNDS: THE POOL IS SHRINKING

Performance is lousy. Fees are high. And suddenly, other investments look juicier

BY AARON PRESSMAN

WHILE BUBBLE watchers were obsessing over the housing market last summer, a soft hissing sound started emanating from the general direction of the capital markets. It didn't come from stocks, bonds, or even oil, all of which went on to close the year flat to positive.

The leak was in hedge funds, a \$1.1 trillion industry that had doubled since 2000. By December the air was gushing out. Net money flows into hedge funds, which are investment pools available mainly to institutional and wealthy individual investors, were down 44% in the third quarter from a year earlier, according to industry statistics. And they slowed to almost nothing in the fourth quarter, observers say.

As the flows dried up, so did many

hedge funds. Chicago's Hedge Fund Research Inc. reported in December that through Sept. 30, a record 484 funds, more than 6% of the total, had shut down in 2005. Figures for the fourth-quarter aren't available yet, but they're sure to be even worse, says Minneapolis hedge fund manager Andrew Redleaf. He describes the situation as a "recession for hedge funds," and says things are even bleaker than the data show because the numbers are based on unaudited results reported to industry groups. Some ne'er-do-well funds might overstate their results, while others might not report anything.

What went wrong for funds? In a word,

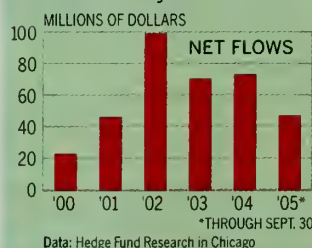
performance. While indexes of 1 funds vary, Standard & Poor's mer which tracks 42 funds across nine c ent investing styles, gained just 2. 2005, less than the 4.9% total retu the plain-vanilla S&P 500-stock Some funds investing in emerging kets, health care, and the Asia I

region didn't even perform simple change-traded (see table), according to indexes compiled by the Hennessey Fund Advisory in Palm Beach, FL

On top of that, private equity funds are taking a tear, with estimated inflows of a record \$100 billion in 2004 from \$52 billion in 2004, according

LOW TIDE

Hedge fund inflows slowed dramatically in 2005



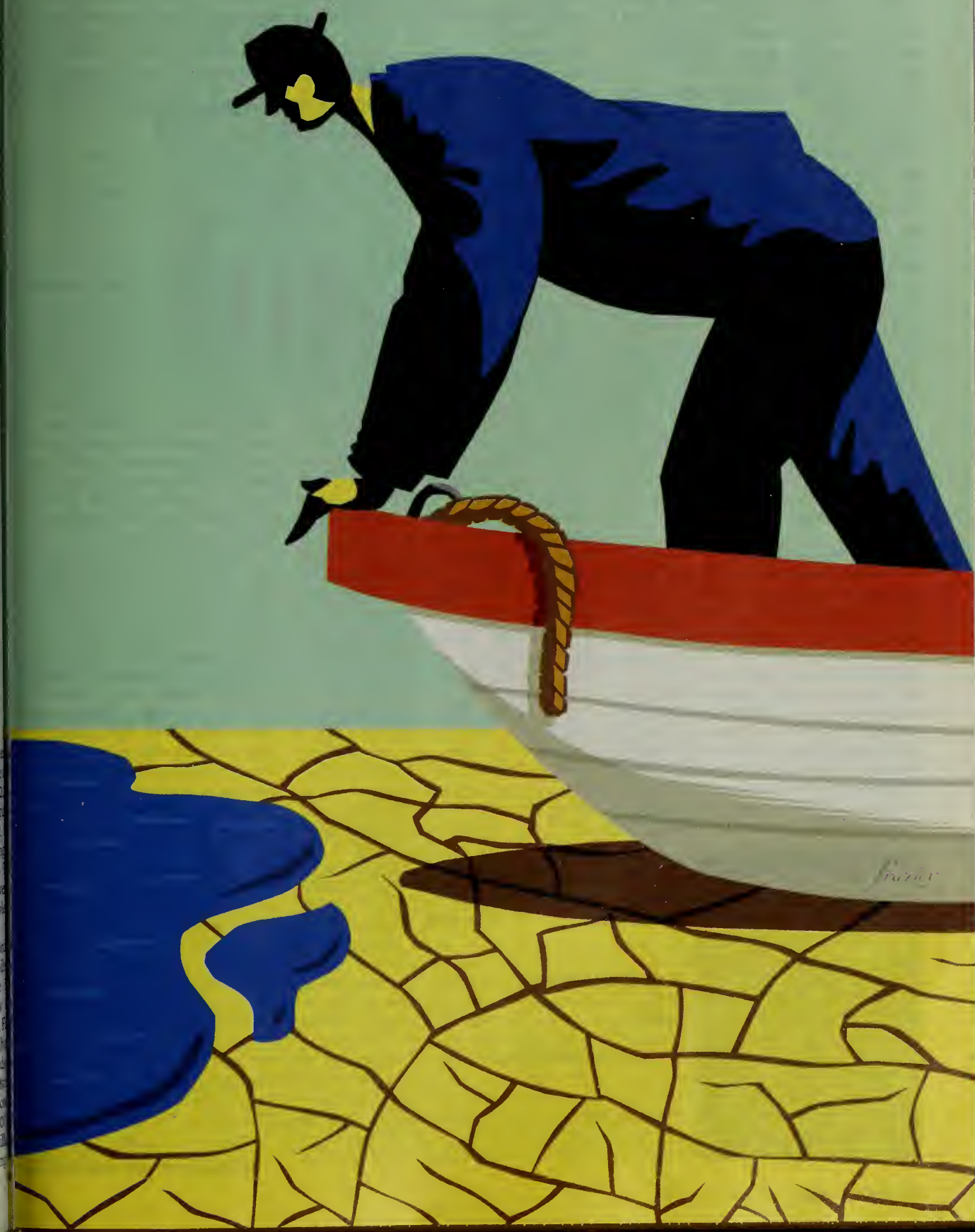
IN THIS SECTION:

Those "sponsored"
newspaper columns

36 Bitter pills: The rising
cost of cancer drugs

40 Is WB losing its edge
with teenage girls?

44 How Google is getting
trounced in Korea



National Venture Capital Assn. "The really smart money is leery of getting into hedge funds now," says John S. Griswold, executive director of the Commonfund Institute, which educates institutions about investing. Private equity, along with energy and natural resources, is picking up the refugees.

The hedge fund boom began just about the time the bull market for stocks ended. Institutional investors, facing crippling losses in their equity portfolios, took note of the huge returns generated by funds that were making bearish bets on stocks and using leverage from options and other derivatives to juice their results further. With low barriers to entry, new hedge funds sprouted up everywhere, from the marbled corridors of Wall Street to the home offices of former day traders. The money pouring into them was staggering: \$74 billion in 2004, compared with just \$23 billion in 2000, according to Hedge Fund Research. Even retail shops like Charles Schwab Corp. and OppenheimerFunds Inc. jumped on board, offering hedge "fund-of-funds" investments, or shares of funds that invest in other hedge funds, to customers with as little as \$25,000 in assets.

PRICEY LAGGARDS

BUT THE FUNDS' high fees and rigid rules, coupled with the paltry returns, have been their undoing. The typical fund charges 1% to 2% of assets under management, plus 20% to 50% of any profits. Many funds also require that investors lock up their money for a long time, often a year or more, before selling. All of this was fine from 2000 to 2002, when hedge funds were beating the stock market handily. Now they're laggards—priced laggards that are hard to get out of.

Some investors have had enough. When the final numbers are tallied, in-

flows for 2005 could be as low as \$40 billion, almost all of that money coming in the first half of the year, says Robert I. Schulman, chief executive of Tremont Capital Management Inc., a fund-of-funds manager.

Gold rushes tend not to pan out for latecomers. The endowments at Harvard and Yale Universities took big positions earlier in the decade that paid off famously. But many of the newer entrants haven't fared as well. Consider the University of Minnesota's \$800 million endowment, which suffered investing losses between 1999 and 2002 as the Internet bubble popped. In 2003, then-new Chief Investment Officer Stuart Mason put 5% of assets into hedge funds. Six months later, he had 12% invested with 10 funds. Now, after mixed results, he plans to cut back on hedge funds and enter more promising areas such as timber, oil and gas, and distressed debt. "We're not huge fans of hedge funds," says Mason.

Many smaller investors have been turned off completely. Last summer an investment adviser suggested that the \$77 million Scherman Foundation Inc., a nonprofit foundation in New York, try hedge funds, but Treasurer Michael Pratt didn't bite. "At this point, we're reluctant to get in," he says.

High-profile hedge fund blowups, including the debacle of Wood River, chronicled in these pages in October, haven't helped matters. The \$450 million Bayou Group LLC turned out to be an outright fraud. Its July, 2005, closure was particularly unsettling because well-

known industry consultants like the Hennessee Group had clients in the fund. Bayou principals Samuel Israel III and Daniel E. Marino pleaded guilty to fraud charges in September, and investors have filed lawsuits hoping to recover any money Bayou might have stashed away overseas. William Bloss, a lawyer for some

of its investors, says clients don't want anything to do with hedge funds anymore. "People are much less comfortable with this word," says Bloss.

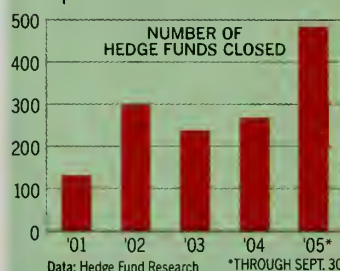
The hedge fund industry isn't going away. Only 14 months ago, former Goldman Sachs & partner Eric Min raised \$3 billion for his Eton Park hedge fund, reportedly

the biggest sum in 15 years. Plenty of Wall Street superstars will join him in the future. And when the stock market clawed by the bears again, investors will be less concerned about the high charges by hedge funds and more concerned of their returns.

The recent slump in performance, says Kevin Quirk, a principal at Casey, Quirk & Acito LLC, an adviser to institutional investors, can be viewed as the result of hedge funds doing what they do best: taking less risk than other kinds of investments, and giving up some gain to protect against potential losses. "Hedge funds weren't very popular during this year bull market," says Quirk. However, "when the idea of downside risk became more prominent again, people were turning to hedge funds." In the near time, however, many investors will be turning away. ■

A SENSE OF CLOSURE

A record number of hedge funds liquidated their assets in 2005



Why Bother With Hedge Funds?

Hedge funds are notorious for their high fees and for requiring investors to lock up money for a long time. In 2005 some low-cost exchange-traded funds (ETFs) gave hedge funds a run for their money.

HENNESSEE HEDGE FUND INDEXES 2005 PERFORMANCE*

ASIA-PACIFIC	+19.94%
EMERGING MARKETS	+9.51
EUROPE	+16.23
HEALTH CARE/BIOTECH	+2.71
TECHNOLOGY	+6.31

*Includes fees

ETF ALTERNATIVES 2005 PERFORMANCE

iShares MSCI Pacific ex-Japan (EPP)	+13.5%
iShares MSCI Japan Index (EWJ)	+24.3%
iShares MSCI Emerging Markets Index (EEM)	+32.6%
streetTRACKS Dow Jones Euro STOXX 50 (FEZ)	+8.4%
Health Care Select Sect SPDR (XLV)	+6.4%
iShares NASDAQ Biotechnology (IBB)	+2.4%
Technology Select SPDR (XLK)	-0.3%

Data: Hennessee Group, Morning

BBYING

THIS OPINION BROUGHT TO YOU BY...

Health sponsorship of talking heads and op-ed columnists is surprisingly common

BY AMON JAVERS

IN THE OPINION INDUSTRY, PUNDITS who present themselves as independent voices sometimes turn out to be quietly financed by powerful interests.

The latest example *BusinessWeek* has unearthed: *The Hill*, a Washington newspaper read closely in Congress, published an opinion piece last week extolling "payday loans." Readers weren't told that the author, Tom Lehman, a professor at Indiana Wesleyan University, had taken money from the industry that pushes these controversial high-interest loans.

In other instances, *BusinessWeek* Online has recently identified Douglas Bandow and Michael Fumento, two prolific authors of newspaper opinion pieces who received undisclosed payments from business interests they wrote about. Both of their nationally syndicated columns as a result. Fumento acknowledged just last week that in 1999 he benefited from payments totaling \$60,000 from agribusiness giant Monsanto Co., a subject of praise in Fumento's opinion columns and a book. Cops Howard News Service canceled his column. Bandow resigned last month from Copley News Service after he admitted writing as many as two dozen op-eds for which he was paid \$1,000 to \$2,000 a piece by embattled Washington lobbyist Abramoff.

The phenomenon of pundit payola drew attention early last year when conservative commentator Armstrong Williams lost his weekly column with Tribune Media Services and apologized publicly after media reports that he had accepted \$240,000 from the Bush Administration to applaud White House education policies. Two other columnists were found to have accepted government cash in the Williams affair.

editor of *The Washington Post's* editorial page. The paper receives about 100 op-ed submissions a day, and Hiatt frets that a few undisclosed conflicts of interest might get past him.

In November, the *Post* published an "editor's note" concerning an op-ed that had run earlier that month under the byline of Newt Gingrich, the former Speaker of the House. Gingrich had criticized specialty hospitals that focus narrowly on select fields and "cherry-pick only the easy cases." Gingrich, the paper explained, hadn't disclosed that HCA Inc., a major hospital chain that competes with specialty hospitals, and an industry trade group had contributed financially to the

Center for Health Transformation, an outgrowth of Gingrich's Washington consulting firm. A Gingrich aide, Rick Tyler, took the blame for the incident. Tyler said it was he, not Gingrich, who had failed to alert the paper to the potential conflict.

CIRCUITOUS PATH

SOMETIMES stealth sponsorship of media opinions is more convoluted. Such was the case with economist Lehman's friendly column about payday loans published last June in *The Hill*, the thrice-weekly paper aimed at lawmakers and their staffs. Payday lenders offer high-interest loans secured by the borrower's next paycheck. Consumer advocates say the expensive loans exploit the working poor. "Although payday loans are often criticized for being too costly, my analysis suggests that they are actually less expensive than bank overdraft services for many consumers," Lehman wrote. He was identified only as a professor at Indiana Wesleyan in



More often, money flows from an industry or a lobbyist rather than a branch of government. The tradecraft for fixing media opinions varies and sometimes involves public relations firms, Washington front groups, or other intermediaries.

All this has editors at some of the country's most prestigious newspapers worried. "The value of a good op-ed page is that we are presenting, we hope, the best, most provocative, and most substantive unpurchased opinion," says Fred Hiatt,

Marion, Ind.

But the article's origins weren't so simple. Lehman says he had been paid \$1,000 to \$2,000 by an outfit called the Consumer Credit Research Foundation to analyze payday loans. The foundation has neither offices nor employees. A phone number on its Web site leads to Washington PR man Robert Hoopes, who says the group is funded by the payday-loan industry. Hoopes, a former Democratic congressional staffer, says he repackaged

Lehman's research as an op-ed for *The Hill*, but he sees nothing improper about it. "We are funded by the payday-loan industry, and we have always been very up front about that," he says. "Tom's work for the foundation is extremely well known, including in press releases and among his peers."

Lehman also insists there was no conflict. He says he disclosed his industry paycheck to his university, which, he adds, encourages professors to publish frequently. He says he was paid only for the initial research, not the op-ed piece.

The Hill's editor, Hugo Gurdon, says he can't recall whether he knew about the industry's role in Lehman's op-ed. But the editor says that if he had known, he probably would have rejected the piece or at least required that the potential conflict be disclosed.

In the Monsanto case, the company acknowledged after inquiries from BusinessWeek Online this month that it had indirectly paid \$60,000 to columnist Fumento. The money went to the conservative Hudson Institute in Washington. Hudson passed along most of it as part of his

salary as a senior fellow at the institute. Fumento says the rest was used for overhead at Hudson. He adds that the money supported his book *BioEvolution: How Biotechnology Is Changing Our World*, which was published in 2003 and lauded Monsanto and the biotech industry. Fumento says he didn't reveal the company's backing in the book at Monsanto's request. Company spokesman Chris Horner doesn't dispute this but says Monsanto records don't indicate that the money was for a book. Disclosing the payment "would be a credibility issue in terms of the book," Horner says.

Fumento says that he saw no conflict of interest in recent newspaper columns defending agribusiness and biotech crops because the Monsanto grant came several years ago. "If you're thinking quid pro quo," he says, "I think there's a statute of limitations on that." The money didn't influence his writing, he adds. His syndicate, Scripps Howard, felt differently. On Jan. 13 it canceled Fumento's weekly column. ■

Pundit payola can be hidden by complex deals

SPENT Even with extensive insurance the Thorntons struggle financially



BIOTECH

GOING BROKE TO STAY ALIVE

Rising prices for cancer treatments are making patients—and doctors—balk

BY CATHERINE ARNST

AVASTIN IS ONE OF THE most important cancer treatments to come along in a decade. Developed by Genentech Inc. and approved in the U.S. two years ago, it can add months to the lives of the sickest patients with colon, lung, and breast cancer, a triple crown no other recent cancer drug can claim. Still, Genentech announced this month that

Avastin's recent sales are running 10% lower than many Wall Street analysts had expected.

The reason isn't hard to figure. Avastin costs anywhere from \$4,400 to \$8,800 a month. The drug has Federal Drug Administration approval on the treatment of colon cancer, so insurers are refusing to pay for it against breast and lung cancer. "It's naive to think that a patient's ability to pay wouldn't affect the practice of medicine," says Dr. Neal J. Meropol of



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Chase Cancer Center in Philadelphia.

Cancer has always been an expensive disease, but the stratospheric prices of the newest drugs are injecting cost into treatment decisions to a degree rarely seen before. As a result, some doctors, patients, and even whole nations are beginning to reject the latest treatments, no matter how effective.

Drug companies argue that the high prices are necessary to offset development costs of these complex drugs. They also

relieve side effects can cost \$100 a pill.

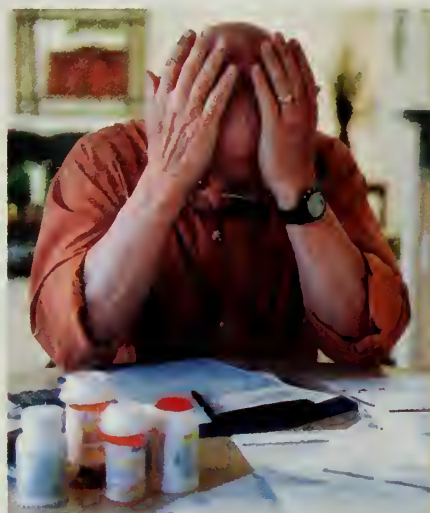
Insurers are watching this trend with alarm. Most drugs are only prescribed for FDA-approved uses, but oncologists routinely administer cancer drugs for unapproved, or off-label, uses if supported by clinical trial data. Medicare is required to pay for most off-label cancer treatments, and private insurers used to follow suit, but recently they have started to balk. Morgan Stanley surveyed 100 U.S. oncologists in December and found that their

effective at preventing recurrence, but a Belgian study released last month calculated that Herceptin would cost European governments \$42,000 per patient if used for that purpose. "It is possible that patient budgets will not be able to bear extra expense," the authors warned.

In America, even patients with generous insurance policies are struggling with the expense. H. Wayne Thornton, Albuquerque, a supervisor with the Forest Service, was shocked when he

diagnosed with breast cancer in 1996. The year-old has gone through surgery and numerous rounds of chemo. He is now trying to survive on a combination of Herceptin, Avastin, and Abraxane, a new chemotherapy from American Pharmaceutical Partners Inc.—at a cost of about \$25,000 a month.

Thornton pays a premium of \$388 per month to cover his wife, Betty, himself. Still, his co-pay is total hundreds of dollars each month for these drugs. He also has co-pay for pain killers, anti-nausea



The High Price of Cancer Care

For a decade, Wayne Thornton of Albuquerque, N.M., has been struggling both with cancer and with the bills for his life-saving medicines. His latest chemo regimen:

ABRAXANE

Taken once every three weeks

COST PER TREATMENT

\$8,152

HERCEPTIN

Once a week

COST PER TREATMENT

\$4,550

AVASTIN

Once every two weeks

COST PER TREATMENT

\$4,506

note that the newer products are more effective and safer. Before these were available, "the patients died quickly, so their treatment didn't impact the cost of health care," says Ian T. Clark, head of Genentech's commercial operations.

"SOMETHING HAS TO GIVE"

NOW THE IMPACT IS OBVIOUS. Most of the newest treatments are taken along with older chemotherapies, and some are even taken in combination with one another, adding pricey drug on top of pricey drug. Dr. Leonard Saltz of Memorial Sloan-Kettering Cancer Center in New York says that 10 years ago the drugs used to treat colon cancer cost about \$500. Today, the tab is \$250,000. Over the same 10-year period, the average life expectancy for colon cancer patients increased from 11 months to a little more than two years. "We're excited about these drugs," he says, "but not everyone can get them. Something has to give."

Avastin is far from the only cancer drug raising such concerns. ImClone Systems Inc.'s Erbitux costs \$30,000 for eight weeks of treatment. Gleevec, a Novartis drug, costs \$2,200 a month and can be taken indefinitely. Herceptin, a Genentech drug for breast cancer, runs \$3,200 a month. And anti-nausea drugs to

off-label use of Avastin for breast and lung cancer was very low, even though clinical data showed the drug could improve survival for those diseases. The doctors said they expect to step up their use of Avastin once they are assured of reimbursement. "We're finally beginning to see some pushback on off-label uses," says Dr. Steven Harr, a Morgan Stanley analyst.

Even so, drug companies have little incentive to lower prices. New cancer drugs have patent protection, there are virtually no me-too drugs, and desperate patients have been known to mortgage their homes to pay for treatment. Plus, Medicare is forbidden from negotiating prices with drug companies. "You might see some pressure in three to five years to moderate prices, but there are no forces at work now," says Eric Schmidt, analyst with S.G. Cowen & Co.

That leaves oncologists and patients with tough choices. Doctors say many breast cancer patients routinely refuse a new class of drugs known as aromatase inhibitors, which prevent the disease from recurring, because they can't afford them. Herceptin is also ef-

fective at preventing recurrence, but a Belgian study released last month calculated that Herceptin would cost European governments \$42,000 per patient if used for that purpose. "It is possible that patient budgets will not be able to bear extra expense," the authors warned.

Oncologists are also fighting doctors. Because they administer most cancer drugs intravenously, the doctors buy the drugs themselves and bill patients at a razor-thin markup. "It's an incredible bind," says Dr. Barbara McAneny, Thornton's doctor. She would like to give patients state-of-the-art treatment every time, "but you have to live in the real world. When the patient says, 'I can't afford it,' I start to think about second-best."

All drug manufacturers have programs that provide medicines free of charge to uninsured patients. Last year Genentech spent \$200 million on such subsidies.

But that doesn't address all the problems of the uninsured. "I have patients who refuse treatment time because they can't come up with the money," says Dr. Craig Hildreth, a St. Louis oncologist. He says he does not believe his patients have been denied a chance at prolonged survival because of their inability to pay. Yet. ■

The costly drugs are better, so patients live longer and pay more

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RATINGS DRAMA

THE WB: OVER THE HILL AT 11?

The network sparks solid DVD sales, but an aging audience is worrisome

BY RONALD GROVER

THE WB TELEVISION network's recipe for most of its hit shows was always pretty simple: Mix hunks with babes and add a liberal splash of sexual innuendo. And it worked. By the late '90s, the WB was Teen Girl Central. Not anymore. The Gen Yers advertisers covet are tuning out in droves, and speculation is rife that Time Warner Inc.'s 11-year-old network will go the way of its recently canceled show, *7th Heaven*.

But the WB is not about to follow its sappy family drama into oblivion. Not yet anyway. And you can thank the zany economics of the TV business for that. Yes, ratings are down for 6 of the 10 shows that returned this season. And it's true that the WB has lost \$80 million over the past two years. But Time Warner seems prepared to choke down the losses. That's because the Warner Bros. studio, producer of most of the network's pro-

gramming, makes a mint selling DVDs and reruns of shows that attract even a modest following. It's a neat trick—and one that is getting harder to pull off with ratings down 13% from last year. "All the ancillary revenue doesn't mean a thing," says Albie Hecht, a former president at Spike TV, "unless you have something someone wants to see."

The WB is unlike the other networks in one crucial respect. The likes of Fox and UPN can sop up red ink with profits from their TV stations, which make money selling local ads. Warner Bros. owns no stations. And that's where the DVDs and reruns brighten the picture. For example, the studio gets an estimated \$850,000

SUPERNATURAL It costs \$1 million an episode to make an episode by s ing reruns of Superboy dra Smallville to ca

The WB also sells DVDs, along v *Smallville Magazine* subscriptions teens for \$37.75 a year. And it gets a from the soundtracks of such show *Gilmore Girls* and *One Tree Hill*.

AGING AUDIENCE

TO GENERATE THOSE ancillary enues, the WB needs big enough rat to satisfy advertisers, though. They i rectly foot much of the bill for : shows as *Supernatural*, which cost estimated \$1 million an episod make. Yet ratings this year fell by for *One Tree Hill*, now in its third and 24% for four-year-old *Ever* Worse, as several shows have age have the viewers. Since 2002, the median age has risen by six years, t most 37. "That could be deadly for a work that sells young demos," says Adgate, research director of media ing agency Horizon Media Inc.

Advertisers aren't fleeing so far, bu WB isn't taking any chances. It laid o people, about 15% of the staff, in De ber. Axing *7th Heaven* was another cutting move; the show lost the W million last year, due to highly con sated stars and falling ratings. And Warner makes most of the 12 show the current schedule, the WB has to outside for ratings grabbers, such as *Beauty and the Geek*.

The WB doesn't have forever to ri ratings, what with corporate raider C Icahn at Time Warner's gate. A rene ed deal with Tribune Co., which 22.5% of the WB and carries program on its 19 affiliates, could help. Tha tract has been held up for months, rise to speculation that Tribune co

fuse to pay for tl shows it carrie cripple the ne Tribune also coul Warner Bros. fro tributing on the shows that woul pete against its st

But the new says WB Cha Garth Ancier, wil allow his comp sell shows via th That's another v the ratings-chal network to eke c enues as it battle claim its lost you

The WB's Lost Youth

	MILLIONS OF VIEWERS AGE 12-34	PERCENTAGE CHANGE*
ABC	2.63	0
Fox	2.53	-5
CBS	2.21	-4
NBC	1.96	-21
UPN	1.54	+9
WB	1.33	-13

Data: Horizon Media, Nielsen Media Research.
* Q4/05 vs. Q4/04

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INTERNET ABROAD

THE LITTLE SEARCH ENGINE THAT COULD

Korea's NHN thumps Google at home, and it's teaching the big dogs a new trick

BY MOON IHLWAN

QUICK. WHAT'S THE HOTTEST Internet search company on earth? If you answered Google, you'd be wrong by at least one metric. While the Silicon Valley sensation doubtless had a great year in 2005, shares of a Korean rival—NHN Corp.—have done far better. Google Inc.'s stock climbed an impressive 103% in 2005, to nearly \$415, but that paled beside NHN's 218% gain to \$267.

Sure, NHN is still a midget compared with Google (page 80). Its revenues leapt 53% last year, to \$351 million, while earnings should come in at \$86 million, Daewoo Securities estimates. Google, meanwhile, is expected to post profits of \$1.7 billion on \$4 billion in net sales. Google remains a power stock despite a hit in mid-January on fears that it's overvalued.

But in its home market, NHN's Naver.com search engine trounced Google's offering. Google's 4-year-old Korean-language search service accounts for less than 2% of search page views and search-related ad revenues in Korea. Under CEO Kim Beom Su's adroit direction, NHN sold about \$228 million in online ads last year, nearly 40% of the country's total. "In the vibrant and volatile Korean Internet sector, NHN is clearly the star," says Jay Park, an analyst at Samsung Securities in Seoul. "NHN's user-friendly approach outshined its rivals." Google declined to comment for this story.

Why is Naver so popular? One reason is that Naver can deliver more relevant search results than Google can, at least on its home turf. A simple Google search will return only certain kinds of Web pages, and a user needs to click another link to find, say, related images or news stories. NHN offers a mix of categories including blogs and community sites unless the

user specifies a particular kind of document. A Naver search for a subway station, for instance, will return a map, information on the subway line serving the station, connecting bus lines, restaurants and shops near the station, blog entries mentioning it, and more. "Google has a superb search engine," says Choi Jae Hyeon, NHN's search chief. "We have, however, built up knowhow and a database by extracting knowledge from users' brains."

GODS AND MORTALS

WHAT HE'S TALKING about is a three-year-old initiative called "Knowledge-In." The program lets users ask and answer questions on anything from recipes for kimchi to the composition of rocket fuel. Readers judge the responses, and the millions of folks who have answered questions are ranked as "ordinary," "knowledgeable," "highly knowledgeable," "supernatural," or—for 22 truly prolific answerers—"gods." "Naver is great because you get all sorts of detailed information in very specific questions and an-

swers," says Song Han Sil, a 25-year pianist in Seoul. "Many of my friends even know that Google offers Korean language service." The database now has some 37 million questions and answers that can get returned with search results. The idea is so popular among Koreans that it has become one of the most other search engines in the country, including Yahoo! Korea, now offers its own versions of Knowledge-In service.

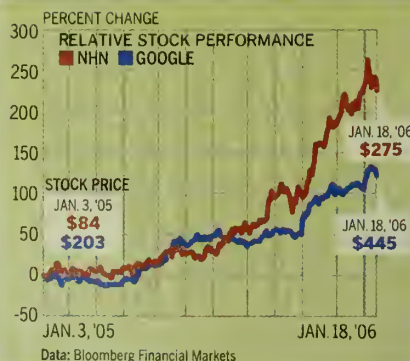
Soon, Google may start running NHN elsewhere, too. After stumbling with Naver in Japan in 2000 (it pulled the plug four years later), the company is using online games—everything from chess and solitaire to elaborate role-playing contests—as its entry into Japan, China, and the U.S. Already, NHN is the largest game publisher in Japan with 13 million subscribers, while in Korea it bought half of Ourgame.com, a portal with 170 million subscribers, in October it set up a subsidiary in the U.S. to launch online games. NHN hopes to introduce community and search services in those markets. Google may still be far ahead, but it would do well to keep an eye out for the little Korean search engine. ■

—With Elizabeth Woyke in New York and Ben Elgin in San Mateo



NET GAINS
CEO Kim gets credit for NHN's rapid ascent

NHN vs. GOOGLE



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EDITED BY RICHARD S. DUNHAM

The GOP's Risky AMT Gambit

THE BUSH ADMINISTRATION HAS SIGNED on to congressional Republicans' strategy to play a high-stakes game of political chicken over the alternative minimum tax. After years of reining in the AMT with stopgap measures, some GOP leaders now plan to leave the unpopular levy unchecked, threatening as many as

6 million more high-end taxpayers with a higher tax tab for 2006. Their hope: Increased public pressure to fix the AMT will force the GOP to extract concessions from Democrats, including lower rates on capital gains and dividends. But if the gamble goes wrong, millions of corporate managers and middle-collar workers could be steaming at both parties for playing games with their tax returns.

Spreading the Pain

REPUBLICANS ARE counting on help from high-income families concentrated in such states as New York, California, Connecticut, and New Jersey, where big deductions for state and local taxes tend to trigger the AMT. Democratic senators such as

California's Dianne Feinstein and New York's Hillary Clinton and Charles Schumer have been pushing to get rid of the alternative levy. Added pressure to reach expands could make those and other Democrats more willing to trade an AMT fix for the tax cuts the GOP wants, a top Administration official says.

The AMT is a parallel tax system that hits upper-middle-class families by limiting personal exemptions and some itemized deductions, notably state and local taxes. Since 2001, Congress has hit millions of taxpayers out of the AMT's clutches with temporary increases in the income level at which the tax kicks in. But a last-minute snag in 2005 prevented Congress from approving another patch. As a result, the number of households paying the AMT could rocket from 3.5 million last year to 20 million on 2006 returns filed in April, 2007.

In the short run, some conservatives want to use AMT relief as leverage to lock in the current low rates on capital gains and dividends, which are due to expire at the end of 2008. "A potential AMT crisis in the spring gives us an opportunity to get cap gains and dividends," says Heritage Foundation Vice-President Michael Franc. GOP leaders want to increase the pressure on Senate Democrats to cut a deal by April 15, when accountants will start warning clients that the higher AMT could boost the estimated tax payments they need to make. But most of the 16 million families first facing the AMT this year won't even know they're paying more until next year, says Martin Nissenbaum, director of personal finance and taxes at Ernst & Young.

In the longer run, some Republicans believe that growing public pressure for fixing the AMT will drive efforts for fundamental tax reform. Their logic: Repealing the AMT will cost up to \$1 trillion over 10 years, and the only way to pay for that is to raise other taxes by killing deductions. House Ways &



THOMAS The AMT could fuel public pressure for tax reform

Means Committee Chairman William M. Thomas (R-Calif.), along with other key lawmakers and top Administration advisers, figure that taxpayers will have to feel the AMT's sting before they'll embrace that trade-off. "Why would voters want to give up tax benefits they do have in exchange for relief from a tax they are not paying yet?" says one former top White House aide. Carrying out that strategy, however, would mean letting taxpayers feel the full brunt of the AMT for a couple of years, not just a couple of months. That may be a bigger risk than the GOP ever wants to face. ■

—By Howard Gleckman

CAPITAL INSIDER

A RARE DISSENT FROM THE BUSH PARTY LINE

THE ENVIRONMENTAL Protection Agency's science advisory committee is about to launch an attack on the Bush Administration's proposed rules for air quality. In late December the EPA proposed to cut nearly in half the allowable short-term level of exposure to very fine particles of pollution emitted by power plants, diesel engines, and other sources. But the agency declined to reduce the limit for the average annual level of particulates in an area. That's inadequate, says **Dr. Rogene Henderson**, biochemist at the Lovelace Respiratory Research Institute in Albuquerque and chair of the independent science panel. The new regulations could cost thousands of lives annually, scientists estimate. The outside advisory committee is planning a Feb. 3 teleconference to discuss how to push for stricter standards.

BUSINESS JITTERS OVER LOBBYING LIMITS

IS PAYING for lawmakers to visit exotic locales an integral part of lobbying? Yes, say some K Street stalwarts. A proposed ban on privately funded travel, which House GOP leaders are considering, is overkill akin to the post-Enron corporate reform rush of 2002, many lobbyists say. "I think in some cases they go too far," says **R. Bruce Josten**, executive vice-president of the U.S. Chamber of Commerce. "There is some travel that is legitimate, purposeful, and advantageous." Lobbyists should make their case soon: **House Speaker Dennis Hastert** (R-Ill.) and Democrats already are trying to outdo each other as champions of lobbying reform.

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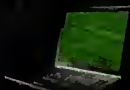
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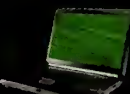
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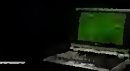
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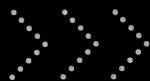
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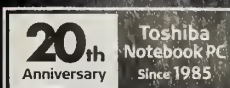
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The Future of Outsourcing

HOW IT'S TRANSFORMING
WHOLE INDUSTRIES AND
CHANGING THE WAY WE WORK

BY PETE ENGARDIO

GLOBALIZATION HAS BEEN brutal to midwestern manufacturers like the Paper Converting Machine Co. For decades, PCMC's Green Bay (Wis.) factory, its oiled wooden factory floors worn smooth by work boots, thrived by making ever-more-complex equipment to weave, fold, and print packaging for everything from potato chips to baby wipes.

But PCMC has fallen on hard times. First came the 2001 recession. Then, two years ago, one of the company's biggest customers told it to slash its machinery prices by 40% and urged it to move production to China. Last year, a St. Louis holding company, Barry-Wehmiller Cos., acquired the manufacturer and promptly cut workers and nonunion pay. In five years sales have plunged by 40%, to \$170 million, and the workforce has shrunk from 2,000 to 1,100. Employees have been traumatized, says operations manager Craig Compton, a muscular former hockey player. "All you hear about is China and all these companies closing or taking their operations overseas."

But now, Compton says, he is "probably the most optimistic I've been in five years." Hope is coming from an unusual source. As part of its turnaround strategy, Barry-Wehmiller

plans to shift some design work to its 160-engineer center in Chennai, India. By having U.S. and Indian designers collaborate 24/7, explains Vasant Bennett, president of Barry-Wehmiller's engineering services unit, PCMC hopes to slash development costs and time, win orders it often missed due to engineering constraints—and keep production in Green Bay. Barry-Wehmiller says the strategy already has boosted production at some of the 32 other midsize U.S. machinery makers it has bought. "We can compete and create great American jobs," vows CEO Robert Chapman. "But not without offshoring."

Come again? Ever since the offshore shift of skilled workers sparked widespread debate and a political firestorm three years ago, it has been portrayed as the killer of good-paying American jobs. "Benedict Arnold CEOs" hire software engineers, computer help staff, and credit-card bill collectors to exploit the low wages of poor nations. U.S. workers suddenly face a grave threat, with even highly educated tech and service professionals having to compete against legions of hungry college graduates in India, China, and the Philippines willing to work twice as hard for one-fifth the pay.

Workers' fears have some grounding in fact. The primary threat of most corporate bean counters jumping on the offshoring bandwagon has been to take advantage of such "labor



SCORE OPERATIVE
Indian
ers, Bennett
y hopes to keep
Converting
e Co.
ing in Wisconsin

A man in a grey suit stands in a large, empty industrial building with high ceilings and large windows. He is looking up at a large blue rectangular box that contains the text "Some think start-up." The floor is highly reflective, showing the man's reflection.

Some think
start-up.

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e”—the huge wage gap between industrial and developing nations. And without it, big layoffs often accompany big outsourcing deals.

he changes can be harsh and deep. But a e enlightened, strategic view of global sourcing is starting to emerge as managers get a better n its potential. The new buzzword is “transnational outsourcing.” Many executives are overing offshoring is really about corporate with, making better use of skilled U.S. staff, even job creation in the U.S., not just cheap es abroad. True, the labor savings from glob- sourcing can still be substantial. But it’s peanuts compared to enormous gains in efficiency, productivity, quality, and rev- es that can be achieved by fully leveraging offshore talent.

hus entrepreneurs such as Chapman see a chance to turn and dying businesses, speed up their pace of innovation, or d development projects that otherwise would have been un- rdable. More aggressive outsourcers are aiming to create cal business models that can give them an edge and change game in their industries. Old-line multinationals see off- ing as a catalyst for a broader plan to overhaul outdated of- operations and prepare for new competitive battles. And le some want to downsize, others are keen to liberate ex- sive analysts, engineers, and salesmen from routine tasks so y can spend more time innovating and dealing with cus- ers. “This isn’t about labor cost,” says Daniel Marovitz, nology managing director for Deutsche Bank’s global busi- nes. “The issue is that if you don’t do it, you won’t survive.” he new attitude is emerging in corporations across the U.S. Europe in virtually every industry. Ask executives at Penske

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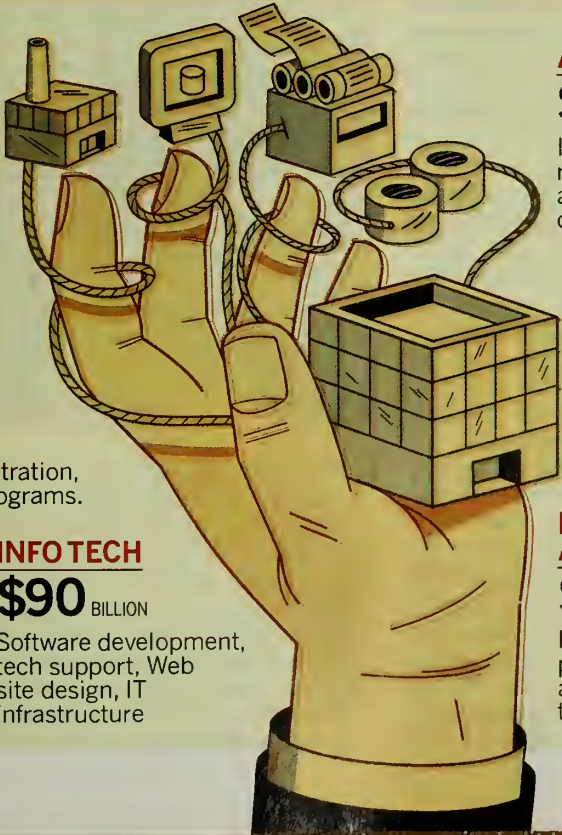
Truck Leasing why the company outsources dozens of business processes to Mexico and India, and they cite greater efficiency and customer service. Ask managers at U.S.-Dutch professional publishing giant Wolters Kluwer why they’re racing to shift software development and editorial work to India and the Philippines, and they will say it’s about being able to pump out a greater variety of books, journals, and Web-based content more rapidly. Ask Wachovia Corp., the Charlotte (N.C.)-based bank, why it just inked a \$1.1 billion deal with India’s Genpact to outsource finance and accounting jobs and why it handed over adminis- tration of its human-resources programs to Lincolnshire (Ill.)-based Hewitt Associates. It’s “what we need to do to become a great customer-relationship company,” says Director of Corporate Development Peter J. Sidebottom. Wachovia aims to reinvest up to 40% of the \$600 million to \$1 billion it hopes to take out in costs over three years into branches, ATMs, and personnel to boost its core business.

Here’s what such transformations typically entail: Genpact, Accenture, IBM Services, or another big outsourcing specialist dispatches teams to meticulously dissect the workflow of an entire human resources, finance, or info tech department. The team then helps build a new IT platform, redesigns all processes, and administers programs, acting as a virtual subsidiary. The contractor then disperses work among global networks of staff ranging from the U.S. to Asia to Eastern Europe.

In recent years, Procter & Gamble, DuPont, Cisco Systems, ABN Amro, Unilever, Rockwell Collins, and Marriott were among those that signed such megadeals, worth billions. In 2004, for example, drugmaker Wyeth Pharmaceuticals transferred its entire

The Modular Corporation

Work processes in practically every big department of a corporation can now be outsourced and managed to some degree offshore. Some of the biggest sectors in terms of global spending in 2005:



HUMAN RESOURCES

\$13 BILLION
Includes payroll administration, benefits, and training programs.

ENGINEERING

\$27 BILLION
Testing and design of electronics, ships, machinery, or parts, etc.

INFO TECH

\$90 BILLION
Software development, tech support, Web site design, IT infrastructure

ANALYTICS

\$12 BILLION
Includes market research, financial analysis, and risk calculation

CUSTOMER CARE

\$41 BILLION
Call centers for tech support, air bookings, bill collection, etc.

MANUFACTURING

\$170* BILLION
Contract production of everything from electronics to medical devices

FINANCE & ACCOUNTING

\$14 BILLION
Includes accounts payable, billing, and financial and tax statements

LOGISTICS & PROCUREMENT

\$179 BILLION
Includes just-in-time shipping, parts purchasing, and after-sales repairs

clinical-testing operation to Accenture Ltd. "Boards of directors of virtually every big company now are insisting on very articulated outsourcing strategies," says Peter Allen, global services managing director of TPI, a consulting firm that advised on 15 major outsourcing contracts last year worth \$14 billion. "Many CEOs are saying, 'Don't tell me how much I can save. Show me how we can grow by 40% without increasing our capacity in the U.S.,'" says Atul Vashistha, CEO of outsourcing consultant neoIT and co-author of the book *The Offshore Nation*.

Some observers even believe Big Business is on the cusp of a new burst of productivity growth, ignited in part by offshore outsourcing as a catalyst. "Once this transformation is done," predicts Arthur H. Harper, former CEO of General Electric Co.'s equipment management businesses, "I think we will end up with companies that deliver products faster at lower costs, and are better able to compete against anyone in the world." As executives shed more operations, they also are spurring new debate about how the future corporation will look. Some management pundits theorize about the "totally disaggregated corporation," wherein every function not regarded as crucial is stripped away.

PROCESSES, NOW ON SALE

IN THEORY, IT IS BECOMING possible to buy, off the shelf, practically any function you need to run a company. Want to start a budget airline but don't want to invest in a huge back office? Accenture's Navitaire unit can manage reservations, plan routes, assign crew, and calculate optimal prices for each seat.

Have a cool new telecom or medical device but lack market researchers? For about \$5,000, analytics outfits such as New Delhi-based Evalueserve Inc. will, within a day, assemble a team of Indian patent attorneys, engineers, and business analysts, start mining global databases, and call dozens of U.S. experts and wholesalers to provide an independent appraisal.

Want to market quickly a new mutual fund or insurance policy? IT services providers such as India's Tata Consultancy Services Ltd. are building software platforms that furnish every business process needed and secure all regulatory approvals. A sister company, Tata Technologies, boasts 2,000 Indian engineers and recently bought 700-employee Novi (Mich.) auto- and aerospace-engineering firm Incat International PLC. Tata Technologies can now handle everything from turning a conceptual design into detailed specs for interiors, chassis, and electrical systems to designing the tooling and factory-floor layout. "If you map out the entire vehicle-development process, we have the capability to supply every piece of it," says Chief Operating Officer Jeffrey D. Sage, an IBM and General Motors Corp. veteran. Tata is designing all doors for a future truck, for example, and the power train for a U.S. sedan. The company is hiring 100 experienced U.S. engineers at salaries of \$100,000 and up.

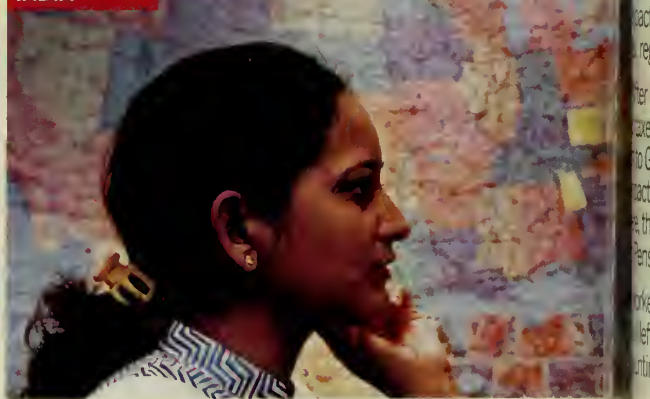
Few big companies have tried all these options yet. But some, like Procter & Gamble, are showing that the ideas are not far-fetched. Over the past three years the \$57 billion consumer-products company has outsourced everything from IT infrastructure and human resources to management of its offices from Cincinnati to Moscow. CEO Alan G. Lafley also has announced he wants half of all new P&G products to come from outside by 2010, vs. 20% now. In the near future, some analysts predict, Detroit and European carmakers will go the way of the PC industry, relying on outsiders to develop new models bearing their brand names. BMW has done just that with a sport-utility vehicle. And Big Pharma will bring blockbuster drugs to market at a fraction of the current \$1 billion average cost by

A Virtual Subsidiary At Work

Some companies and global outsourcing partners work so tightly that they practically are part of the same organization. Here's a look at how Penske and India's Genpact collaborate on one process.



HYDERABAD, INDIA



allying with partners in India, China, and Russia in molecular research and clinical testing.

Of course, corporations have been outsourcing management of IT systems to the likes of Electronic Data Systems, IBM, and Accenture for more than a decade, while Detroit has long given engineering jobs to outside design firms. Futurists have envisioned "hollow" and "virtual" corporations since the 1970s.

It hasn't happened yet. Reengineering a company may make sense on paper, but it's extremely expensive and entails big risks if executed poorly. Corporations can't simply be snapped apart and reconfigured like LEGO sets, after all. They are complex



LANCASTER,
PENNSYLVANIA



JUAREZ,
CHIHUAHUA,
MEXICO

When Penske buys a truck and leases it (top), Genpact's Indian staff remotely secures state taxes, registrations, and permits electronically.

After the truck is returned, the driver's log and taxes, fuel, and toll documents are sent to Genpact. The paperwork is forwarded to Genpact's office in Juarez, Mexico (center). Here, the staff enters data from the drivers' logs into Penske's computer system.

Workers in Genpact's office in Hyderabad, India (left), process all the data for tax filings and accounting.

Organisms that can be thrown into convulsions if a transition operation is botched. Valued employees send out their résumés, customers are outraged at deteriorating service, a brand name can be damaged. In consultant surveys, what's more, many U.S. managers complain about the quality of offshored work and unexpected costs.

But as companies work out such kinks, the rise of the offshore option is dramatically changing the economics of reengineering. Millions of low-cost engineers, financial analysts, consumer marketers, and architects now readily available via the Web, CEOs see a quicker payoff. "It used to be that companies struggled

The New Frontiers of Outsourcing

Major Players An expanded look at Gartner Inc.'s analysis of the who, what, where, and how much of offshore outsourcers

Case Studies Offshore outsourcing is helping companies such as Bank of America, Penske Truck Leasing, Wolters Kluwer, and Eli Lilly save money and transform their operations

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for a few years to show a 5% or 10% increase in productivity from outsourcing," says Pramod Bhasin, CEO of Genpact, the 19,000-employee back-office-processing unit spun off by GE last year. "But by offshoring work, they can see savings of 30% to 40% in the first year" in labor costs. Then the efficiency gains kick in. A \$10 billion company might initially only shave a few million dollars in wages after transferring back-office procurement or bill collection overseas. But better management of these processes could free up hundreds of millions in cash flow annually.

Those savings, in turn, help underwrite far broader corporate restructuring that can be truly transformational. DuPont has long wanted to fix its unwieldy system for administering records, payroll, and benefits for its 60,000 employees in 70 nations, with data scattered among different software platforms and global business units. By awarding a long-term contract to Cincinnati-based Convergys Corp., the world's biggest call-center operator, to redesign and administer its human resources programs, it expects to cut costs 20% in the first year and 30% a year afterward. To get corporate backing for the move, "it certainly helps a lot to have savings from the outset," says DuPont Senior Human Resources Vice-President James C. Borel.

Creative new companies can exploit the possibilities of offshoring even faster than established players. Crimson Consulting Group is a good example. The Los Altos (Calif.) firm, which performs global market research on everything from routers to software for clients including Cisco, HP, and Microsoft, has only 14 full-time employees. But it farms out research to India's Evaluate and some 5,000 other independent experts from Silicon Valley to China, the Czech Republic, and South Africa. "This allows a small firm like us to compete with McKinsey and Bain on a very global basis with very low costs," says CEO Glenn Gow. Former GE exec Harper is on the same wavelength. Like Barry-Wehmiller, his new five-partner private-equity firm plans to buy struggling midsize manufacturers and use offshore outsourcing to help revitalize them. Harper's NexGen Capital Partners also plans to farm out most of its own office work. "The people who understand this will start from Day One and never build a back room," Harper says. "They will outsource everything they can."

Some aggressive outsourcers are using their low-cost, super-efficient business models to challenge incumbents. Pasadena, (Calif.)-based IndyMac Bancorp Inc., founded in 1985, illustrates the new breed of financial services company. In three years, IndyMac has risen from 22nd-largest U.S. mortgage issuer to No. 9, while its 18% return on equity in 2004 outpaced most rivals. The thrift's initial edge was its technology to process, price, and approve loan applications in less than a minute.

But IndyMac also credits its aggressive offshore outsourcing strategy, which Consumer Banking CEO Ashwin Adarkar says has helped make it "more productive, cost-efficient, and flexible than

our competitors, with better customer service.” IndyMac is using 250 mostly Indian staff from New York-based Cognizant Technology Solutions Corp. to help build a next-generation software platform and applications that, it expects, will boost efficiency at least 20% by 2008. IndyMac has also begun shifting tasks, ranging from bill collection to “welcome calls” that help U.S. borrowers make their first mortgage payments on time, to India’s Exlservice Holdings Inc. and its 5,000-strong staff. In all, Exlservice and other Indian providers handle 33 back-office processes offshore. Yet rather than losing any American jobs, IndyMac has doubled its U.S. workforce to nearly 6,000 in four years—and is still hiring.

SUPERIOR SERVICE

SMART USE OF OFFSHORING can juice the performance of established players, too. Five years ago, Penske Truck Leasing, a joint venture between GE and Penske Corp., paid \$768 million for trucker Rollins Truck Leasing Corp.—just in time for the recession. Customer service, spread among four U.S. call centers, was inconsistent. “I realized our business needed a transformation,” says CFO Frank Cocuzza. He began by shifting a few dozen

Big Pharma is pursuing huge boosts in efficiency as well. Lilly & Co.’s labs are more productive than most, having leased eight major drugs in the past five years. But for each new drug, Lilly estimates it invests a hefty \$1.1 billion. That could reach \$1.5 billion in four years. “Those kinds of costs are fundamentally unsustainable,” says Steven M. Paul, Lilly’s science and tech executive vice-president. Outsourcing figures heavily in Lilly’s strategy to lower that cost to \$800 million. The drug maker now does 20% of its chemistry work in China for one-quarter the U.S. cost and helped fund a startup lab, Shanghai Chem-Explorer Co., with 230 chemists. Lilly now is trying to slash the costs of clinical trials on human patients, which ran from \$50 million to \$300 million per drug, and is expanding such efforts in Brazil, Russia, China, and India.

Other manufacturers and tech companies are learning to capitalize on global talent pools to rush products to market sooner at lower costs. OnStor Inc., a Los Gatos (Calif.) developer of storage systems, says its tie-up with Bangalore engineering-services outfit HCL Technologies Ltd. enables it to deliver customized products to clients twice as fast as its major rival. “If we want to recruit a great engineer in Silicon Valley, our lead time is three months,” says CEO Bob Miller. “With HCL, we

Hot Players in the Offshore Outsourcing World

Consultant Gartner Inc.’s clients ask most about these companies’ offshore offerings. For estimates of outsourcing revenues, areas of specialty, and location of operations, go to www.businessweek.com/go/outsourcing

BUSINESS SERVICES	SOFTWARE DEVELOPMENT	CALL CENTERS
1 Hewitt Associates U.S.	1 Tata Consultancy Services INDIA	1 Convergys U.S.
2 ACS U.S.	2 Infosys Technologies INDIA	2 Wipro INDIA
3 Accenture U.S.	3 Wipro INDIA	3 ICICI OneSource INDIA
4 IBM U.S.	4 Accenture U.S.	4 ClientLogic U.S.
5 EDS U.S.	5 IBM U.S.	5 24/7 Customer INDIA
6 Hewlett-Packard U.S.	6 Cognizant Technology Solutions U.S.	6 SR.Teleperformance FRANCE
7 Wipro INDIA	7 Satyam INDIA	7 eTelecare International U.S.
8 HCL Technologies INDIA	8 Patni Computer Systems INDIA	8 SITEL U.S.
9 Tata Consultancy Services INDIA	9 EDS U.S.	9 Teletech U.S.
10 WNS Global Services INDIA	10 CSC U.S.	10 CustomerCorp. U.S.

Data: Gartner Inc. Ranking based on frequency of queries from Gartner’s 10,000 global clients.

data-processing jobs to GE’s huge Mexican and Indian call centers, now called Genpact. He then hired Genpact to help restructure most of his back office. That relationship now spans 30 processes involved in leasing 216,000 trucks and providing logistical services for customers.

Now, if a Penske truck is held up at a weigh station because it lacks a certain permit, for example, the driver calls an 800 number. Genpact staff in India obtains the document over the Web. The weigh station is notified electronically, and the truck is back on the road within 30 minutes. Before, Penske thought it did well if it accomplished that in two hours. And when a driver finishes his job, his entire log, including records of mileage, tolls, and fuel purchases, is shipped to Mexico, punched into computers, and processed in Hyderabad. In all, 60% of the 1,000 workers handling Penske back-office process are in India or Mexico, and Penske is still ramping up. Under a new program, when a manufacturer asks Penske to arrange for a delivery to a buyer, Indian staff helps with the scheduling, billing, and invoices. The \$15 million in direct labor-cost savings are small compared with the gains in efficiency and customer service, Cocuzza says.

pick up the phone and get somebody in two or three days.

Such strategies offer a glimpse into the productive use of global outsourcing. But most experts remain cautious. McKinsey Global Institute estimates \$18.4 billion in global work and \$11.4 billion in business-process services have been shifted abroad so far—just one-tenth of the potential offshore market. One reason is that executives still have a lot to learn about using offshore talent to boost productivity. Professor Anand Sahasrabudhe of Northwestern University’s Kellogg School of Management, a self-proclaimed “big believer in total disengagement,” says: “One of our tasks in business schools is to teach people to manage the virtual, globally distributed corporation. How do you manage employees you can’t even see?”

The management challenges will grow more urgent as global salaries dissipate the easy cost gains from offshore outsourcing. The winning companies of the future will be most adept at leveraging global talent to transform themselves and their industries, creating better jobs for everyone. ■

—With Michael Arndt in Green Bay, Wis., and Dean Foust in Charlotte, N.C.



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PLAYBOOK: BEST-PRACTICE IDEAS

Five Offshore Practices That Pay Off

BY MANJEET KRIPALANI

From Dell Inc. to Reuters Group PLC, corporations have run into trouble as they've shifted jobs offshore. But they've persisted since the process is so critical to corporate success. Take Bank of America Corp. It attracted media attention when it laid off hundreds of information technology workers after forcing some of them to train their Indian replacements. But BofA learned from its mistake. "It caused us to make a greater commitment to [retraining] our associates and to explaining the context of changes in the marketplace," says Barbara J. Desoer, BofA's global technology, service, and fulfillment exec. Now BofA gives its workers six to eight months' notice before an offshore move, enough time to train for new assignments or to hunt for jobs.

What are the pitfalls to avoid when outsourcing?



1 Go offshore for the right reasons

DESPITE THE LURE OF LOWER costs and the promise of big gains in efficiency and innovation, it may make sense not to go offshore at all. Can you boost efficiency and competitiveness by shaking up operations or improving technology at home? What's the risk of a damaging backlash from your customers or community? "Offshoring is a powerful lever, but just one [of many]"

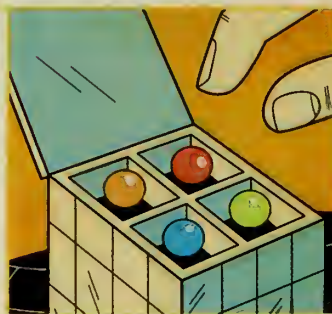
for companies aiming to stay competitive, says Ramesh Venkataraman, McKinsey & Co.'s tech partner for Asia.

Don't decide to send work offshore simply because your competitors are doing it. And don't outsource a mess! "If you have a broken process, shifting it overseas won't fix it," notes Ananda Mukerji, CEO of Bombay call center operator and researcher ICICI OneSource Ltd.



CARTWRIGHT
Found offshore partners for
Wolters Kluwer

What are the best practices to follow? These questions are more pressing than ever as outsourcing takes companies inside out. "The era of lift, shift, and layoff arbitrage is coming to an end," says Sanjeev Aggarwal, chief executive of IBM Daksh Business Services, Big Blue's New Delhi call center operation. "It's all about business transformation today." This playbook offers guidelines companies must keep in mind as they consider such a profound change.



2 Choose your model carefully

AS YOU DEVELOP YOUR strategy, weigh whether you should set up your own subsidiary offshore—known as a "captive" operation—or contract with outside specialists. The appeal of opening your own outfit is that you keep firm control of proprietary technology and processes. For that reason, Boeing Co. opened its own center in Moscow, where it employs 1,100 skilled but

relatively low-cost aerospace engineers on a range of projects, including the design of titanium parts for the 787 Dreamliner jet. Like Chicago-based law firm Baker & McKenzie has its own English-speaking team in Manila that drafts documents and does market research.

One downside of captive units, warns Gartner Inc., is that they can wind up cost-

head office more than it
ld to hire large outside
sourcers that spread
head among numerous
omers. For that reason,
y companies are
oting for the best of both
lds. BofA established its
India subsidiary, yet also



teamed up with Infosys
Technologies and Tata
Consultancy Services Ltd. to
shift 30% of its IT resources
offshore. Since 2001, says the
bank, offshoring has helped
save it \$100 million and,
more important, improved
product quality.

3 Get your people on board

IN MIND THAT

employees and middle
managers can make your
move happen—or stop
it in your tracks. Dutch
bank ABN Amro was aware of
this risk when it decided in
2004 to boost efficiency and
product quality by uniting
oil, investment, private
banking, and asset
management businesses
under one technology
platform, to be developed
inshore. Senior executives
faced resistance. “When you
approach outsourcing,
it’s a religious issue,” says
Lars Gustavsson, ABN
Amro’s London-based group
chief information officer.
“People either believe in it or
they don’t.”

To counter potential
opposition, the bank set up a
full-time communications
department dedicated to
explaining the move to
middle managers and staff.
Senior executives held town
hall meetings with employees
and involved the unions in
managing the shift. And the
bank gathered together its 12
chief technology officers into
a committee that made
decisions by consensus about
redeploying the workforce
and selecting outsourcing
partners. Although some
1,500 jobs will be lost, ABN
Amro is helping with
severance and retraining—
and still expects to save more
than \$300 million annually
starting in 2007.



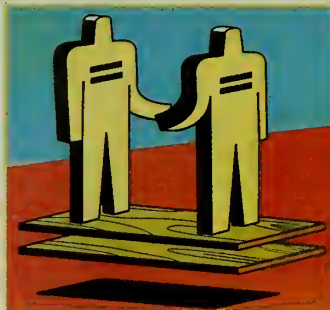
4 Be prepared to invest time and effort

GARTNER POINTS OUT,
36% of companies cite cost-
savings as the main reason
for outsourcing. But you
won’t save as much after the
initial year unless you’re

prepared to invest serious
management time and
effort. “It took a heck of a lot
more involvement on the
part of myself and my team
than I expected,”

acknowledges Frank
Cocuzza, chief financial
officer of Penske Truck
Leasing, which has shifted
work on more than 30
business operations to India,
Mexico, China, and Brazil
since 2000.

To keep its leasing and
logistics businesses
humming, Penske invests
heavily in teaching its
contractors English language
skills—not just so that call-
center workers sound fluent
to U.S. customers but also so
that Penske’s own managers
can better understand them.
Offshore workers also receive



WHILE WORKING WITH

offshore partners can be
scary at first, outsourcing
veterans agree that the gains
are greater if you regard
them as equals. “If you try to
treat these suppliers as a
body shop—telling them
exactly what to do and how
to do it—it does not go well,”
says Christopher Cartwright,
CEO of the corporate and
financial services division of
Dutch-American publisher
Wolters Kluwer.

Cartwright headed the
company’s pilot offshore
project in 2003, when it
contracted with Tata
Consultancy and HCL
Technologies Ltd. to develop
new technology for delivering
the publisher’s compliance
products online. “We tried to
map out everything so there
would be no doubt what we
wanted,” he recalls. “We
didn’t invite the partner to
help us determine the best
way” to make the project
work, he adds. Cartwright felt
his company did not get the

intensive training in Penske’s
business practices. And
Cocuzza sends operational
managers to meet with their
offshore counterparts at least
twice a year.

Quality control is also
important once the offshore
project is up and running,
particularly for more
complicated tasks. What’s
often lacking in offshore
partners “is a lot of deep
process knowledge, whether
it’s mortgage processing,
insurance, or other areas,”
says Gartner Research
Director Frances
Karamouzis.

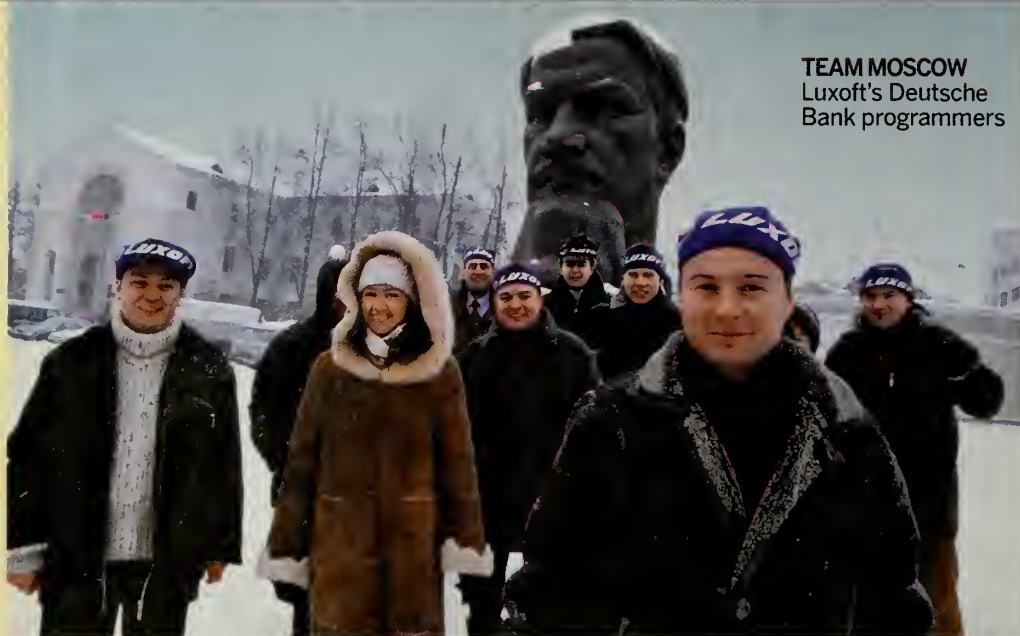
5 Treat your partners as equals

maximum payoff from its
initial project as a result. Now
he ensures that his company’s
project managers and
software architects work
closely with their counter-
parts from India onshore for
a period to organize their
work efficiently.

In a very different industry,
HT Capital Management
Ltd., a \$300 million hedge
fund in Hong Kong, has
teamed up with New Delhi-
based Evalueserve Inc. Four
financial analysts from the
Indian company write
research and market analysis
for HT, working closely with
four analysts from HT. “We
make them feel part of our
team,” says Ophelia Tong,
HT’s investment director.

Outsourcing is still more
of an art than a science. But
it’s now part of the corporate
toolkit, and it’s important to
use this tool right.

—With Dean Foust in
Charlotte, N.C., Stanley
Holmes in Seattle, and
Pete Engardio in New York



TEAM MOSCOW
Luxoft's Deutsche
Bank programmers

Angling to Be The Next Bangalore

BY ANDY REINHARDT

A STANDING OVATION GREETED Mikhail Gorbachev when he took the stage last April in a packed Boston hotel ballroom. But the former Soviet President wasn't there to discuss *perestroika* or Vladimir Putin. Rather, in his speech to the Massachusetts Software Council, Gorbachev talked up Russia's world-class programming skills, urging the audience of 700 executives to send engineering projects to fledgling Russian software shops. World statesman turned pitchman: It's a sign of the growing stakes in global outsourcing, where developing countries from Argentina to Vietnam are scrambling to lure services work from the U.S., Europe, and Japan.

Their inspiration is India. The South Asian giant booked \$22 billion in business last year answering customer phone calls, managing far-flung computer networks, processing invoices, and writing custom software for multinationals from all over the world. Other developing countries see what outsourcing has done for India's economy—including creating more than 1.3 million jobs during the past decade—and want a piece of the action. "National and even regional governments are making increasingly sophisticated efforts to attract offshore services," says Paul Laudicina, head of the Global Business

Some contenders in the global outsourcing race are big developing countries looking to parlay low wages and plentiful labor into export service jobs. China leads the pack, thanks to huge human resources and success attracting manufacturing work. Already a force in writing software built into other products, China is now chasing India's lucrative IT and business services work. Russia, Brazil, and Mexico are likewise piloting offering costs and skills often on par with India's, plus advantages such as closer proximity to U.S. and European markets.

SPECIALIZING

EVEN TINY COUNTRIES SUCH AS Nicaragua, Botswana, and Sri Lanka are trying to grab the brass ring. To lure clients, they're sending trade missions to outsourcing expos, subsidizing training and office parks, and offering tax breaks. "From the President on down, this is a top priority for us," says Juan Carlos Pereira, executive director of Nicaragua's trade promotion agency ProNicaragua. His country has three small telemarketing outfits and an employee support center for the Latin American operations of Spanish telephone giant Telefónica. Hourly wages are about 75% higher than in India, but only half the cost in neighboring Panama and Costa Rica. Pereira hopes to announce a call-center deal with a big U.S. Internet company by March and to create 4,000 new center positions by 2009.

The economic and social benefits extend far beyond immediate jobs. India's software industry association, Nasscom, figures that each new worker in the info tech sector creates seven indirect positions, from janitors to security guards. "Everybody wants to get into the game because it's a virtuous economic development model," says Nasscom Vice-President Sunil Mehta. To compete, countries often must improve their telecommunications, and even business laws—moves that pay long-term dividends. Clean, well-paying jobs boost demand for educated workers, an impetus to improving schools and training. And the high-level skills learned "spill over into the economy as a whole," says Diana L.

**IN INDIA THE
RULE OF THUMB
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JOB INDIRECTLY
CREATES WORK
FOR SEVEN
OTHER PEOPLE**



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director of the McKinsey Global Institute.

Still, success isn't guaranteed. Because they lack India's scale and experience, emerging rivals have to differentiate themselves sharply to win contracts, says Kris Wadia, a London-based partner at Accenture Ltd. who runs the consultancy's global delivery network. Egypt is selling itself as a low-cost specialist in European language call centers. Singapore and Dubai say their safety and legal systems give them an edge in handling high-security and business-continuity services. The Philippines, a former U.S. colony, draws on long-standing cultural ties and solid English skills to snare Anglophone call-center work. And Central and South American countries use their Spanish skills to grab call-center contracts for the Hispanic market in the U.S.

New players are also taking advantage of a growing desire by corporations to spread out their outsourcing. "Companies don't want to have all their eggs in one basket, as far as India is concerned," says Michael Henderson, Asia managing director for Tampa-based call-center operator Sykes Enterprises Inc., which has 37 facilities scattered from Costa Rica to the Philippines. Instead, clients are adding "near-shore" locations only a few hours away by air and usually in proximate time zones. For U.S. outsourcers, that's Latin America, where back-office operations are blossoming from Argentina to the Rio Grande. European companies turn to Central and Eastern Europe, the Middle East, and Africa.

Russia is also playing the near-shoring card, but it's aiming at high-end programming jobs. With its strong engineering culture dating to the Cold War, Russia is brimming with underemployed talent available at rates about one-fifth those in the U.S. A handful of local champions has emerged, including Moscow-based ITCI and a firm called DataArt Inc. that has

AS WESTERN COMPANIES SPREAD THEIR OFFSHORING AROUND, EGYPT, RUSSIA, EVEN BOTSWANA STAND READY

engineers in St. Petersburg and a head office in New York. None has yet matched the success of Moscow's Luxoft, which snagged high-profile jobs developing a document management system for Boeing and a sophisticated customer management tool for Deutsche Bank. "We offer quality, dedication, and most of all, stability, which is difficult to find in India," says Luxoft CEO Dmitry A. Loschinin.

Perhaps the biggest surprise these days is the emergence of Africa as an outsourcing hub. Led by South Africa, which already has more than 500 call centers serving companies such as Lufthansa and General Electric Co. in England,

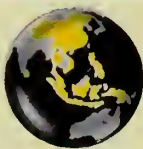
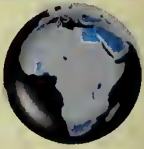
Dutch, and other languages, other countries on the continent are jumping on the bandwagon. Cairo-based Xceed Contact Center handles calls in Arabic and European languages for Microsoft, General Motors, Oracle, and Carrefour. The latest hopeful is Botswana, which is promoting English skills, a strong bond with the U.S., tax breaks, and subsidies for training to attract call centers.

The rise of so many new locations for outsourcing is forcing existing providers to get even more global. U.S. companies such as IBM and Accenture Ltd. are beefing up their presence in Central Europe and Brazil. Indian giants such as Infosys Technologies Ltd. and Tata Consulting Services Ltd. are buying or opening operations in China and Europe. And No. 2 Mexican outsourcer Neoris Inc., which runs centers in Monterrey and Rosario, Argentina, is opening a facility in Budapest to handle European clients. "The point is to serve customers where they are," says Carlos Castilla, vice-president for services outsourcing at Neoris. And to tap into the talent of countries hungry to join the outsourcing craze. ■

—With Manjeet Kripalani in Bombay, Geri Smith in Mexico City, Jason Bush in Moscow, Frederik Balgobin in Manila, and Spencer E. Ante in New York

Outsourcing Goes Global

India still dominates services offshoring, with three-fifths of total industry revenues, but other countries around the world are trying to horn in on the lucrative work

				
REGION	CENTRAL AND EASTERN EUROPE	CHINA AND SOUTHEAST ASIA	LATIN AMERICA AND CARIBBEAN	MIDDLE EAST AND AFRICA
Market Size	\$3.3 BILLION	\$3.1 BILLION	\$2.9 BILLION	\$425 MILLION
Top-Ranked* Countries	Czech Republic, Bulgaria, Slovakia, Poland, Hungary	China, Malaysia, Philippines, Singapore, Thailand	Chile, Brazil, Mexico, Costa Rica, Argentina	Egypt, Jordan, United Arab Emirates, Ghana, Tunisia
Up-and-Comers	Romania, Russia, Ukraine, Belarus	Indonesia, Vietnam, Sri Lanka	Jamaica, Panama, Nicaragua, Colombia	South Africa, Israel, Turkey, Morocco
Emerging Local Providers	Luxoft (Russia), EPAM Systems (Belarus), Softline (Ukraine), DataArt (Russia)	NCS (Singapore), Bluem, Neusoft Group, BroadenGate Systems (China)	Softtek (Mexico), Neoris (Mexico), Politec (Brazil), DBAccess (Venezuela)	Xceed (Egypt), Ness Technologies (Israel), Jeraisy Group (Saudi Arabia)

Data: Gartner, A.T. Kearney, Nasscom, BusinessWeek

* Rankings by A.T. Kearney list countries in order of attractiveness for outsourcing, based on costs, people skills, and business environment. (Source: A.T. Kearney Global Services Location Index 2005)



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Built for The Long Haul

Premium quality is what has kept Paccar trucks on a 67-year winning streak



BY MICHAEL ARNDT

HERBERT J. SCHMIDT IS A truck guy, but not just any truck. It's Kenworth or nothing. For the past 20 years, Contract Freighters Inc. has bought only Kenworth rigs, and the chief executive of the Joplin (Mo.) trucking company intends to stick with Kenworth again in 2006, with plans to order at least 700 new trucks. Sure, these 10-wheel diesels cost up to 10% more than rivals' trucks. But when Schmidt factors in everything else—reliability, trade-in value, even the plush interiors that attract better drivers—he says they're worth it. "It's not the price," he says. "It's the quality."

Thanks to loyal customers like Schmidt, Paccar Inc. is king of the road. The Bellevue (Wash.) company, which makes

Kenworth and Peterbilt trucks, is the top capital-goods producer among the *BusinessWeek* 50 list of the best-performing large companies, ranking 16th overall. With record profits and sales in 2005—industry analyst David Bleustein of UBS Securities figures Paccar netted \$1.1 billion on \$14.1 billion in revenue—Paccar has now made money for 67 consecutive years. Analysts predict that streak will easily extend to 68 in 2006, with \$1.3 billion in earnings on sales of \$14.7 billion.

Like a luxury auto maker, Paccar's ability to demand a premium for its trucks lies in its focus on quality, in everything from product design to technology to dealer experience. To that end, Chairman Mark C. Pigott, 51, great-grandson of the company founder, benchmarks Paccar against industry leaders in a variety of businesses. He measures his information technology group



against Microsoft Corp. and boasts that Paccar's custom manufacturing model is every bit as efficient as Dell Inc.'s. People may scratch their heads at the peer group Pigott has chosen, he says, "but that's what pushes us to be a world leader." In Feb. 13 ceremony, Paccar will receive the National Medal of Technology, conferred by the Commerce Dept., for its legacy of innovation.

That outside-the-truck thinking makes sense for Paccar. Today, commercial trucks are mostly commodities, mass-produced for big fleet operators whose topmost concern is the sticker price. Paccar, however, still custom-builds trucks to individual specifications. Buyers are offered thousands of options, from engine and axles to upholstery and the dials on the dashboard. Part by part, they design the truck they want on a computer with a dealer. Orders are then zapped to Paccar factories, where workers assemble trucks for delivery six to eight weeks later.

Paccar has spared no expense to be a technological innovator. Its computerized machinery can make prototypes of parts in hours, rather than the days or weeks it takes to sculpt them out of foam or clay. That allows the company to upgrade models more frequently. To afford the outlays, Paccar big rigs list for \$115,000 to \$120,000, more than models from DaimlerChrysler's Freightliner, the market leader. But drivers love them. "It's

KING OF THE ROAD Peterbilt and Kenworth are Paccar brands

similar to Harley Davidson," says Ken Jorgensen of Wausau, Wis., who owns eight Peterbilt dealerships. "The

product's got a mystique."

That kind of brand equity ought to help Paccar keep its profits streak going even with some speed bumps ahead in 2007, stricter federal standards on diesel engines go into effect. Compliant engines are expected to cost as much as \$8,000 more, while getting worse mileage. As a result, trucking companies are likely to move orders up to 2006, damping demand next year. Analyst Brian M. Rouse of FTN Midwest Research Securities Corp. in Cleveland sees Paccar's profits falling to \$930 million in 2007 and then sliding to \$12.5 billion. Pigott looks beyond the down cycle, however. As long as it keeps producing the best product, says Paccar, it will keep cruising. ■

BusinessWeek online For a Q&A with Paccar CEO Mark C. Pigott about the company's innovation efforts, go to businessweek.com/extras

A full-page photograph of Tiger Woods in a black Nike polo shirt and black cap, captured in a celebratory pose after a golf swing. His right arm is raised in a fist, and his left hand holds a golf club. The background is a soft-focus green field.

There's a moment when perfect theory
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The New Kingmakers

Andrea Redmond and Charles Tribbett are shaking up the staid world of executive recruitment

BY ROGER O. CROCKETT

CHARLES TRIBBETT III HAS LOGGED 16 years as an executive headhunter, working with companies ranging from United Airlines to Sprint. He is a calming presence, well respected, universally liked. Over the past two years he has placed several vice-presidents at Nike and proven he could find diverse candidates. Even so, when the company was looking to hire someone it could perhaps groom to be CEO William D. Perez' successor, Tribbett was the underdog for the coveted assignment. That's because he was up against Gerard R. Roche, the blustery kingmaker whose influence extends across Big Business—and the man who had in fact recommended Perez for his job. Many

companies would have chosen Roche, but Nike asked Tribbett to conduct the search, which is still under way. "Charles really understands what we need in the position," says Wes Coleman, Nike's head of global human resources.

Executive recruiting, one of the most exclusive businesses around, is finally opening up its membership. And that is paving the way for fresh faces in the C-suite. The big headhunting firms are all promoting new search talent, including John Thompson at Heidrick & Struggles International Inc. and James Citrin at Spencer Stuart. But perhaps the most notable additions to this elite world are Tribbett and partner Andrea Redmond, co-directors of the CEO & Board practice at Russell Reynolds Associates Inc. The pair has been shaking up the corporate world as they help put in place the next generation of business leaders: Mark V. Hurd at Hewlett-Packard; Jamie Dimon at Bank One, now JPMorgan Chase; Glenn Tilton at United; Gary Forsee at Sprint Nextel. And they are quietly working on a search to replace the CEO at a major company. "Their judgment on peo-

ple is extraordinary," says Dimon.

For years this high-stakes business has been ruled by Roche, 74, senior chairman at Heidrick, and by Thomas J. Neff, 67, chairman of the U.S. arm of recruiting's second-biggest firm, Spencer Stuart. In his 42 years, Roche has been involved in about 185 CEO searches; Neff, who has been at it for 29 years, some 150. Meanwhile, Redmond and Tribbett claim about 50.

Under much of Roche's and Neff's reign, the process had boiled down to a sophisticated game of fetch. During the go-go 1990s, "the whole issue of CEO succession became about attracting a star," says Citrin. At times, Roche and Neff have pulled CEOs from a cozy club of luminaries, or "tall ships," as Roche calls them, whose "masts of talent rise above the pack's."

For example, when Jack Welch named Jeffrey R. Immelt as his successor in late 1999, Roche plucked the much heralded runners up, placing James McNerney at 3M Co. and Robert Nardelli at Home Depot Inc. Then last year, Neff tapped McNerney to fill the



Placing the **Pace-** **setters**

The real test of a headhunter is how well their recruits perform. Here's a look at the best and worst placements in recent years for three of the major players.

% SHAREHOLDER RETURN

ANDREA REDMOND AND CHARLES TRIBBETT: RUSSELL REYNOLDS ASSOCIATES

Mike McGavick

Safeco

Jan. 30, 2001 to

Dec. 30, 2005 **154.1%**

Glenn Tilton

United

started

Sept. 3, 2002 **-67.9**

GERRY ROCHE: HEIDRICK & STRUGGLES INTERNATIONAL

James McNerney

3M

Jan. 2, 2001, to

June 30, 2005 **32.5**

E. Neville Isdell

Coca-Cola

May 3, 2004 **-16.9**

TOM NEFF: SPENCER STUART

Hugh Grant

Monsanto

May 29, 2003 **291.6**

Douglas Conant

Campbell Soup

Jan. 8, 2001 **3.0**

Data: Company reports, Standard & Poor's

PeopleHeadhunters

vacant Boeing Co. job. He also lured John Mack, an ex-Morgan Stanley president, out of retirement when the Morgan CEO position opened up again.

But the corporate world is changing, and along with it, the game of executive search. Today's workforce is far more mobile than it used to be. Loyalty has been usurped by mobility, even at the top. CEO turnover now matches the normal attrition rate for all employees: just about 12% a year, according to quarterly surveys by researcher BNA Inc. The rate of CEO dismissals among the world's 2,500 largest public companies increased by 300% from 1995 to 2004.

resent fresh perspectives in an industry that is in many ways antiquated."

Together they are trying to get companies and their boards to think differently about leadership. "We're going to go beyond the top 10 companies for CEOs," says Tribbett. When he and Redmond are on assignment, they try to become insiders at the company, familiar with its troubles, prospects, and culture. That allows them to suggest candidates whose names the board of directors might not even recognize. Mike McGavick, for example, was an unknown insurance executive running a unit of CNA Financial Corp. when they recruited him for insurer Safe-

recruiters, but "two white guys," Roche laments. A member of HP's board acknowledges part of Redmond's and Tribbett's appeal: "They are not part of the old boys, been-there-done-that, know-everybody network."

PERSONAL SETBACKS

REDMOND AND Tribbett are both high achievers who have overcome animosity and even tragedy to get where they are. Redmond was born in Glen Ellyn, a middle class suburb of Chicago. While still in high school her older brother died in a car crash. Then, just a year after she graduated from college, her father passed away

BIO

Charles Tribbett

BORN Oct. 25, 1955, in Alexandria, La.; moved to Chicago's South Side at age 2. Father a dentist, mother a social worker.

FAMILY Wife, Lisa, is his childhood sweetheart. They have one daughter, Jillian, 23, and two sons, Charlie, 21, and Jason, 19.

MACHO CHECK He resists wearing an overcoat, hat, or gloves during Chicago winters, betting with colleagues on who can go coatless the longest.

THRILL-SEEKING Skis the blue- and black-diamond runs at Beaver Creek in the Colorado Rockies.

TO RELAX Goes to the movies on weekends with Jillian. They last saw *Hustle & Flo* and *Bad News Bears*.

WHEN HE TRAVELS Buys a movie at the airport to watch on his portable DVD player.

FAVORITE BOOK *The Great Gatsby* by F. Scott Fitzgerald.

FAVORITE FOOD A charcoal-grilled New York strip steak.



Andrea Redmond

BORN Feb. 21, 1956, in Glen Ellyn, Ill., a suburb of Chicago. Father a dentist, mother a fashion model.

FAMILY Husband, Bill Ferguson, real estate investor and consultant; formerly a Russell Reynolds recruiter. One son, Duke, 12.

HEALTH CRISIS Treated for breast cancer from 1999 to 2002. Motto: "A good life is not the same as an easy life. What defines you is what you do when you hit major speed bumps."

THRILL-SEEKING She's a daredevil who loves fox hunting. Her husband had to talk her out of taking the world's longest bungee jump in South Africa.

TO RELAX Rides one of her five horses near her 4½ acre property in the equestrian community of Wayne, Ill.

WHEN SHE TRAVELS She always buys a copy of *People* magazine before boarding a plane.

FAVORITE BOOK *The Road Less Traveled* by M. Scott Peck.

FAVORITE FOOD Anything spicy.



At a time when China and India are the hot markets, Latinos the surging population, and Gen X workers are replacing aging baby boomers, the old way of recruiting leaders doesn't have the same appeal. Redmond, 49, is one of the few women at her level in the industry. Tribbett, 50, is regarded as the highest-ranking African-American. They each argue that their gender, cultural perspective, and relative youth allow them to offer their clients a different worldview than that of Neff and Roche. "There's no inner sanctum more controlled by elder white males than the world of CEO recruiting," says Joseph Daniel McCool, former editor of *Executive Recruiter News*. "Andrea and Charles rep-

co Corp. McGavick transformed the company from a bleeding business into a profitable player and has recently become a serious candidate for the U.S. Senate. In December they found his replacement: Paula Rosput Reynolds, the head of AGL Resources Inc., an energy holding company. Mark Hurd had a low profile at middling NCR Corp. before Redmond and Tribbett convinced HP's board to meet with him. So far, he has led HP to two straight quarters of earnings growth. In hindsight, Roche says, he wishes he had let Joie A. Gregor, a female partner at Heidrick, bid for the job. Instead, John Thompson and CEO Thomas J. Friel made the pitch. Two highly accomplished

after suffering a stroke. To help cope with these losses, Redmond threw herself into her job as an internal recruiter at the First National Bank of Chicago. But the banking world wasn't for her, and she left for Russell Reynolds' Chicago office in 1986. There she adapted to the itine lifestyle with ease. Better yet, she played a knack for sensing when a candidate was right for a job. "I've seen hundreds of recruiters," says Peter Cr Russell Reynolds partner at the time, who now heads his own firm. "She has one of the best instincts I've ever seen."

Tribbett, too, made a strong impression early on. In 1989, at age 34, he had already emerged as one of Chicago's top

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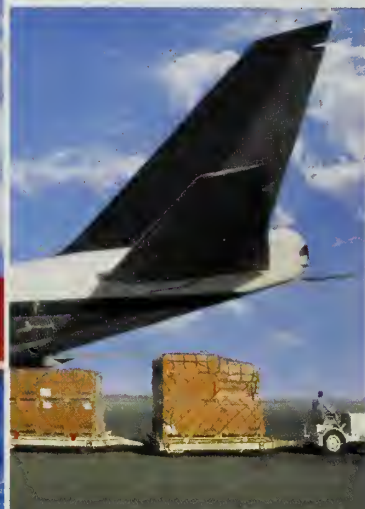
A new study* shows that integrating Medical, Pharmacy and Disease Management benefits with Aetna can help lower medical costs. According to the data, overall costs dropped by 15-20% for high-risk Aetna members with integrated benefits compared to similar members with just medical insurance benefits. That's because integration allows for a better exchange of information to help high-cost, high-risk members better manage their conditions. To find out more, call your broker, Aetna representative, or visit us today at aetna.com.

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PeopleHeadhunters

ing professionals. He grew up on Chicago's South Side and attended Catholic school to avoid the sub-par education of the neighborhood's public schools. After college and a stint on Wall Street, Tribbett had become a successful corporate attorney when Mayor Harold Washington appointed him board chairman of Chicago's huge McCormick Place convention center project.

It took Russell Reynolds the better part of a year to recruit him. No wonder. The firm's culture was characterized by its white-shoe conservatism. Russell C. Reynolds Jr., the founder, was an East Coast blue blood who graduated from Yale University. In the 1970s, Reynolds had to have a black man shine his shoes under the table while he was conducting business, according to McCool, who has died the firm's history.

PLACING ACT

REDMOND HELPED persuade Tribbett to join the firm, and five years later, in 1994, the two were promoted to co-managers of the Chicago office. Tribbett and Redmond have since relinquished the management duties to focus on placing top executives and board members.

As difficult as it sounds, Redmond and Tribbett are yoked as equals. "Like brother and sister," Redmond says. Although he will take the lead in a search—Redmond knows financial services; Tribbett is more comfortable with regulated industries—together they discuss every detail, and both are available to talk with the client. But the real strength of their partnership is their yin-yang personalities. Redmond is fiery and spontaneous; Tribbett is reserved and diplomatic.

The duo produced a sleeper hit for HP last year. In early January, 2005, Redmond got a call from Patricia C. Dunn, the chairman of HP's board of directors, whom Redmond had recruited. Dunn wanted to talk about finding a replacement for the smooth-talking Carleton S. Fiorina, who had just been ousted.

The HP selection committee was looking for a roll-up-your-sleeves-and-get-it-done CEO. Someone with an eye for the bottom line. A leader with the ability to manage multiple, even disparate, business units without a breakdown in execution or teamwork. And they wanted this person in six weeks, tops. Sources familiar with the HP board's thinking say Redmond and Tribbett landed the job because they were prepared to move



HIGH-PROFILE PICKS McGavick and Tilton

at that fast pace. More than anything else, the HP experience demonstrates Redmond's and Tribbett's talent for bringing unconventional but winning candidates to the table. They presented a list of about 15 contenders. Some were perennial targets, such as McNerney and Motorola Inc.'s Edward J. Zander, sources say. But half were people that HP's directors had never heard of. Among those no-name candidates was Mark Hurd, then CEO of Dayton-based NCR. Although NCR is a profitable \$6 billion maker of automated teller machines and big computers, with six distinct business units and more than 28,000 employees, "there was no one on the board who had ever heard of Mark Hurd," admits one of HP's directors. And no one thought NCR had the complexity of HP.

Even so, Redmond and Tribbett were certain Hurd was right for the job, and they worked hard to open the minds of

the board members to that possibility. "If someone shoots you down, you have to come back another day and say, 'I listened and understand what you are saying, but I would like you to hear me out on this,'" Redmond says.

Finally the HP directors consented to meet him. But among themselves, they figured this Hurd character had no chance. At his interview in March he answered a flurry of questions with virtually all the right answers. The board's conclusion: It couldn't "sacrifice skill for a big name," says one member. On Mar. 29, HP appointed Hurd CEO.

The HP post was the sort of stellar opportunity that doesn't come around often. Luring a candidate to take over troubled United Airlines in 2002, on the other hand, truly tested the pair's skills. The right guy for the job, Tribbett thought, was Glenn F. Tilton, who had

helped Texaco Inc. through bankruptcy. Tribbett knew Tilton from work he had done placing senior managers at Texaco. Over steak at a Houston restaurant, Tribbett laid out his proposal without sugarcoating it. "If it's a tremendous challenge, he says so," explains Tilton. "That's a very significant thing."

Challenging is a good way to describe Tilton's job these days. In December, 2002, he led United into bankruptcy, where it has languished ever since. Now, as he brings it out, he's catching grief for a proposal that would give the company's top 405 executives stock worth \$105 million, at least \$15 million of which would go to Tilton. The controversy underscores the fact that even the best-qualified of Redmond's and Tribbett's recruits can falter on the job. That's why Tribbett had been so candid from the get-go. "If you were me, would you take the position?" Tilton had asked him. "No," Tribbett said. "But I'm not you. You might be crazy enough to do [it]." ■

PLAYBOOK: BEST-PRACTICE IDEAS

The Recruiters' Tips for Climbing To the Top

CONSIDER THE TRADE-OFFS

Family time suffers, hobbies get shelved, workless vacations don't exist. "If you're running an organization, you can't wake up Monday and decide to check your e-mail," Redmond says.

BUILD A REPUTATION

Tribbett recommends that executives stay at one company for at least five years. "Two or three years is not enough tenure to demonstrate success," he says.

GET OUT OF THE COUNTRY

There's no substitute for working abroad. Boards want global executives who can diversify the company, Tribbett says, "so ask to be put on the list for an overseas opportunity."

LOOK FOR A COACH

Redmond and Tribbett recommend managers with big ambitions find an executive coach, someone who can advise them on career moves and, once they arrive, serve as a confidant.

How Safe Are Diet Supplements?

FDA regulation is weak, so private watchdogs are stepping in

BY JOHN CAREY

JENNIFER ANGER WAS JUST looking for a bit more energy. So the 25-year-old graphic designer took the recommended dose of Zantrex-3, a dietary supplement billed on the Internet as "America's hottest new Super Pill," offering "rapid weight loss and incredible energy." She got something very different. "My heart started pounding. I thought I was having a heart attack," she says. When that symptom subsided, she was left with a splitting headache.

Anger was stunned that a popular supplement could have such a powerful effect. But Dr. Tod Cooperman isn't surprised. His company, ConsumerLab.com LLC, tests dietary supplements to see what's actually in them. The Zantrex-3 that he analyzed in late 2005 contained a huge amount of caffeine per daily dose: 1,223 milligrams. That's a bigger jolt than you would get from 35 cans of Classic Coke or 12 cups of espresso. "There is a shocking quantity in some of these products," says Cooperman.

Zantrex-3's maker, Basic Research Zoller Laboratories, said in a statement: "At no time do we try to conceal either the xanthine content [caffeine-like substances] or the huge energy boost." The company adds: "Every bottle...cautions those who are sensitive to stimulants to consult with their physician prior to taking Zantrex-3." Still, such Web sites as www.fitnessinfomercialreview.com, where customers report experiences, are full of tales like Jennifer Anger's.

The stories raise a host of issues about the safety and quality of products sold by the \$20.3 billion dietary supplement industry and the seeming failure to regulate them. ConsumerLab, which, for a fee, also

offers seals of approval for companies whose products pass the tests, has found that 25% of the products it tests fail in some way. Some lack the claimed ingredients or levels of ingredients. Others are laced with contaminants. Cooperman has found lead in ginkgo and magnesium supplements, toxic chromium in a weight-loss product, and lacking active ingredients in others (table).

BusinessWeek has learned that key lawmakers led by Senator Dick Durbin (D-Ill.) are near a deal for a new law requiring companies to report to the Food & Drug Administration serious adverse events involving supplements. That would limit harm from a dangerous product. In the meantime, Cooperman's private efforts cast a stark light on the sprawling health supplement industry, which is still struggling to gain credibil-

COOPERMAN
decided to test products and put out the results

ity. And they show how commercial tempts to fill the regulatory vacuum stir up a hornet's nest. "What ConsumerLab is doing is literally extorting," accuses Jarro L. Rogovin, president of Los Angeles supplement maker Jarro Formulas LLC. "They are a viper at mother's breast." Jarro recalled a batch of ginkgo products on Dec. 28, and Cooperman's company discovered the supplements lacked the advertised amounts of active substances. Jarro says that a Chinese supplier was at fault.

What's in That Bottle?

In 25% of products it's not what the label claims, tests show. Some examples

PRODUCT	PROBLEM
GINKGO BILOBA Supposed to improve memory	Three of 13 products tested were contaminated with lead; 7 of 13 lacked the claimed amounts of ingredients
WEIGHT LOSS PRODUCTS E.g. Ripped Fuel, Zantrex-3	Some contained high amounts of caffeine, plus 5 of 11 products tested didn't contain enough of their key ingredients
HORNY GOAT WEED Aimed at sexual dysfunction	All four tested products were either contaminated with lead or lacked the claimed amount of the active substance
CHROMIUM May help in diabetes	One supplement contained a toxic form of chromium; others less—or more—chromium than listed on the bottle
MULTIVITAMINS	Most were O.K., but some lacked the full amounts of claimed ingredients, or contained lead, or didn't dissolve when swallowed

Data: ConsumerLab.com



The turmoil over supplements stretches back to a 1994 law in which Congress decided that the products, unlike pharmaceuticals, don't have to be pre-approved by FDA. Nor must the FDA test them for safety, efficacy, or even quality control. The law created a fast-growing industry. Now, even President George W. Bush takes supplements: multivitamins, omega-3 fatty acids, and glucosamine chondroitin to ease stiffness in his joints. There are still questions about whether the thousands of products on the market. But more important, is the quality to snuff? "People think these things are regulated...but it's pretty much like Wild West," says New York nutritionist Erica Ilton.

THE BULLET

EXPERTS SAY THAT most products contain what the label indicates. Yet even industry leaders concede that there are too many times when this isn't true. "There are still a lot of fly-by-nighters out there. It's a problem the industry is still struggling with," says A. Wes Siegner Jr. of Hyman, Phelps & McNamara, who has served as general counsel for dietary supplement trade associations.

In recent years, the Federal Trade Commission has cracked down on egregious marketing. But the FTC has no authority over manufacturing quality, and it can't

quash all the dubious claims. "Let's just say that I have job security," says Richard Cleland, assistant director of the FTC's division of advertising practices. "It doesn't take too long on the Internet to figure out there is still a problem out there." The FDA is empowered to take supplements it can prove are dangerous off the market, such as those containing ephedra—but it rarely has.

That's why Tod Cooperman saw an opportunity. After medical school, he was more interested in business than in doctoring and was eager to get better information to consumers. The first company he started, CareData Reports Inc., rated health-maintenance organizations and managed-care plans. (It is now owned by J.D. Power & Associates—like *BusinessWeek*, a unit of The McGraw-Hill Companies). After selling CareData, he looked around "for another situation where consumers had no sense of how to distinguish good from bad products," he says.

Dietary supplements fit the bill, even if Cooperman started with no business model. "I just bit the bullet and decided to buy products, test them, and put out the results for free," Cooperman recalls. "But immediately we found an audi-

ence for this kind of information."

ConsumerLab currently has about \$1 million in annual revenues and 25,000 subscribers. "I don't recommend anything that has not been tested," says nutritionist Ilton. Colorado engineer Peter Wagner, 56, found the site about a year ago, and he quickly became a believer: "I read some of the reports and said: 'Man alive! Some of the stuff out there is junk.'"

Consumer advocates say Cooperman is offering vital information, but they believe he's a poor substitute for real FDA regulation. "It's a sad commentary when we have a private-sector lab...doing what should have been part of the law long ago," says Dr. Sidney Wolfe, director of Public Citizen's Health Research Group.

Yet that's a rave review compared with the reaction of supplement makers. After ConsumerLab testing found excessive amounts of lead in a popular children's vitamin, L'il Critters Gummy Vites, the industry's chief trade association, the Council for Responsible Nutrition (CRN), went on the offensive. In January, 2005, it complained to the FTC that Cooperman's enterprise misleads "consumers into believing that ConsumerLab is operating in the

public interest," when its "entire business model represents an egregious form of consumer fraud and deception." Preposterous, retorts Cooperman. The attacks are an example of trying to shoot the messenger, he says. The FTC declined to investigate, and now Cooperman is suing CRN for libel.

Even if they dislike ConsumerLab, though, many supplement makers see a need for third-party evaluators. Pharmavite LLC, makers of "Nature Made" and other products, and several other major companies have signed up with the U.S. Pharmacopoeia, a nonprofit group that sets quality standards. For a fee, the USP will test supplements and enforce rigorous manufacturing standards. "The USP mark is front and center on every one of our Nature Made labels," says Tom Zimmerman, Pharmavite's vice-president of business development.

CRN and others also have been asking the FDA to issue long-awaited rules requiring higher-quality manufacturing processes. Meanwhile, consumers can follow the example of Eileen Begley. The Monterey (Calif.) Realtor, 53, won't buy a supplement until she checks ConsumerLab's tests. "It's a nice feeling that I'm not just taking snake medicine," she says. ■

Nonprofit USP sets voluntary quality standards for makers

HP's Ultimate Team Player

Ann Livermore has helped revive Hewlett-Packard. Her next task will be much tougher

BY PETER BURROWS

ONE JULY EVENING IN Silicon Valley, Hewlett-Packard Co. executive Ann Livermore got the phone call she had waited months to receive. She rushed to the hospital, having learned that a kidney had been donated, and underwent an organ transplant, necessary due to complications from a childhood disease. For most executives, it would have been an opportune time to call it quits after a 24-year career. But three days after the surgery, she was phoning HP Chief Executive Mark V. Hurd and peppering lieutenants with questions. "I finally asked if someone would please go in there and take her laptop away," laughs Hurd.

Why didn't Livermore step down? Opportunity. While the \$33 billion corporate-computing business she runs has long been one of the most glaring underachievers in tech, she's convinced the business is finally ready to show what it can do. Livermore and HP have spent 18 months overhauling the unit, and the benefits are only now becoming visible.

"From the moment I left, I never thought of not coming back," says Livermore, who was out for 5½ weeks. "We have a very special opportunity right now."

It's a dramatic reversal. A year ago her Technology Solutions Group, which sells servers, storage, and consulting services to corporations, was valued at next to nothing by Wall Street analysts. Mercilessly squeezed by IBM and Dell Inc., the unit struggled to show profits or promise. Indeed, while HP's printer business brought in nearly all of the company's earnings, Livermore's unit became a millstone around the neck of former CEO Carleton S. Fiorina, contributing to her ouster a year ago.

Yet Livermore's unit is now a key reason HP's stock is on a tear and the newly arrived Hurd is being hailed as a turnaround maestro. Thanks mostly to cost-cutting and operational improvements, the businesses turned in a 50% increase in operating earnings in fiscal 2005, to \$1.9 billion, on revenues of \$33.2 billion. Overall, HP earned \$4.2 billion for the year, on revenues of \$86.7 billion.

Now, rather than bemoaning how bad the corporate business is, analysts are trying to figure out how good it can be. What

INSIDER, OUTSIDER
Livermore was overhauling her unit as CEO Hurd was hired

was once rated an F has become a C business. Can Livermore bring the grade up to a B or even an A? It's an open question, though there's little doubt the next play will be harder than the last. "They're certainly doing better," says Richard Belluzzo, a longtime HP exec who heads the storage company Quantum Corp. "They've done some good work, particularly on the cost side. But the strategic challenges are pretty much the same."

Harsh perhaps, but true. While Livermore wants its corporate unit to be a leader

Restoring HP's Computing Power

AUG. 12, 2004

HP, under CEO Carly Fiorina, blows its third quarter. The main reason: Miscues in the corporate-computing unit, which Ann



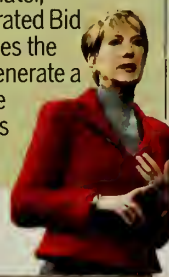
Livermore had taken over months earlier. Fiorina fires corporate sales chief Peter Blackmore.

FALL 2004

HP sets up a war room to fix 15 urgent operational problems in corporate computing. Meanwhile, Chief Technology Officer Shane Robison embarks on an in-depth study of every HP business, designed to uncover areas for cost reductions and operating improvements.

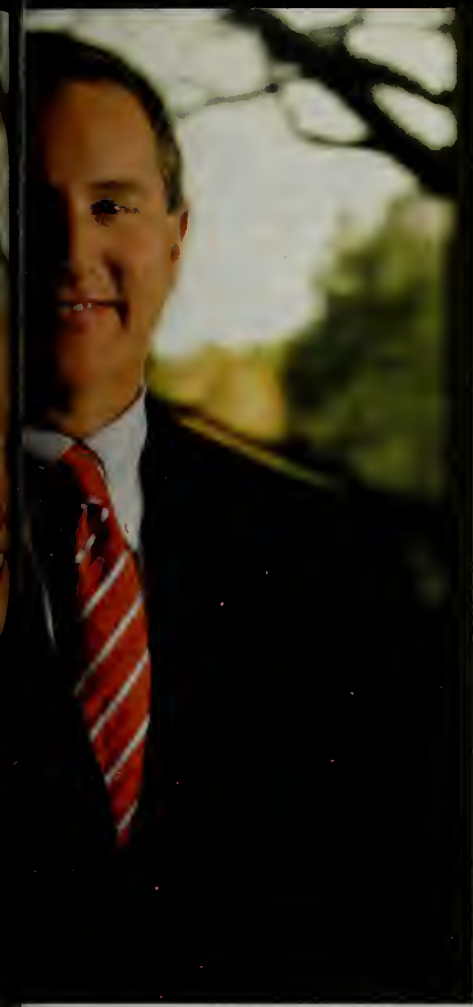
FEB. 7, 2005

Fiorina is ousted. Yet the war room effort is leading to initiatives that will pay dividends later, including an Integrated Bid Desk, which reduces the time required to generate a complex corporate bid from two weeks to a day.



MARCH 2005

Livermore visits technology chiefs at Wall Street firms and then joins a conference leading technologists all over HP. The experience prompts her to advocate a new strategy: the "next generation data center."



utive who now runs storage highflier Network Appliance Inc.

Yet HP is better positioned than in the past. For starters, Hurd has brought the company's costs in line by laying off about 15,000 employees, or 10% of its workforce. It also has a stronger product lineup, particularly in storage and software, where HP has made nine acquisitions in 18 months. Just as important, Hurd and Livermore are beginning to articulate a strategy for corporate customers that's truly distinct from IBM's, not just a similar approach with a different name.

The difference? While IBM leads with its consulting services and its ability to help the top brass devise corporate strategy, HP is focused on helping companies get a handle on the soaring costs of maintaining and powering their tech gear. The goal is to use software and other automation technologies to reduce the number of tech staffers by 90%, at the same time they slash the amount of energy tech equipment uses. Livermore's ideal is a "lights-out" data center, with almost no human involvement.

While IBM goes after chief executives, HP is tailoring its message for chief information officers, the people who oversee corporate technology. "We're focused on addressing CIOs biggest pain point," says Livermore. "Customers are complaining that all their money goes into labor and operating costs. We can be the company to help them automate and manage this, to drive costs out."

In many ways, Livermore is a perfect metaphor for HP. The 46-year-old is competent, respected, but not really feared by

Her idea of a "lights-out" data center has huge appeal for CIOs

rivals. A standout tennis player and valedictorian of her high school in Greensboro, N.C., she earned a coveted Morehouse Scholarship to the University of North Carolina at Chapel Hill. She went straight to business school at Stanford University. There, she won the annual competition for best business plan for running the doughnut concession. Her

secret? She solicited companies that were coming to interview students to buy her sweets by the dozen.

When she joined HP, straight out of Stanford, she never expected to make a career of it. She had watched her father stay at the same insurance company for years and vowed not to get bogged down. But she fell in love with HP's unique culture. Especially appealing was HP's willingness to accommodate working mothers, through flexible working hours and other arrangements. Livermore could dote on her daughter, even as she roared through the ranks. By 1996 she was running the services arm. In 1999, she made a very public run at the CEO job—even hiring an internal press relations person to raise her profile. She lost out to Fiorina and then became a staunch ally.

INAUSPICIOUS START

FOR ALL HER SUCCESS, Livermore still has something to prove. Wall Streeters are wary of her ability to deliver consistent financial results. Even some HP insiders ascribe her rise to a selfless willingness to follow orders. They're quick to point out that she's a solid general manager and universally well-liked but question whether she can rally the troops to challenge a fierce foe like IBM. "She's extremely competent," says one insider, "but I don't see her as a key leader for the long-term." Completing the turnaround

an alternative to IBM, it remains far behind Big Blue in several key areas, including high-end computing, software, and services such as consulting and outsourcing. In software, for example, HP's revenues are about \$1 billion, compared to IBM's \$16 billion. And other rivals expect HP to grow complacent, given its recent improvements. "I'm happy they're being happy about their success, because it means they'll get apathetic—and we'll clean their clocks," says Daniel J. Menhoben, another former HP executive.

A year ago, Hewlett-Packard's \$33 billion corporate computing business was considered a lost cause, valued at nearly nothing by Wall Street. Now it's the key factor in HP's resurgence under new CEO Mark Hurd. Here's how it happened:

MARCH 29, 2005	JULY 19, 2005	NOV. 17, 2005	DEC. 13, 2005
Hurd is named new CEO. He dives into the on study as a guide to cutting costs without missing growth opportunities.	Hurd announces plans to lay off 10% of HP's 150,000 employees and several structural changes. Livermore gets more authority, allowing her to quickly hire more storage sales people to sell a new batch of products.	HP blows past earnings expectations, mostly because profits from servers and storage quadruple. What's more, the perennially money-losing software unit turns a profit.	At a packed Wall Street conference, Hurd unveils the next-gen data center strategy. Analysts now expect profits from HP's corporate business to rise 50% in 2006, to \$3 billion, on sales of \$36 billion.



WALL ST

BIO

Ann Martinelli Livermore

The valedictorian who thought she'd be a corporate vagabond:

BORN Aug. 23, 1958

CHILDHOOD The Greensboro (N.C.) native was competitive from an early age, becoming a standout tennis player and captain of her basketball team.

EDUCATION High school valedictorian. Graduated with a 4.0 grade point average from the University of North Carolina at Chapel Hill in 1980. MBA from Stanford University in 1982.

CAREER HIGHLIGHTS After joining Hewlett-Packard out of Stanford, Livermore helped build HP's computer services unit and became its chief in 1996. She took over HP's entire corporate computing business in 2004 and has led a resurgence in the \$33 billion business. That has helped lift HP shares 57% in the last year.



ROLE PLAYER Livermore badly wanted the CEO spot when it opened up in 1999, but the job went to Carly Fiorina. Then last year she lost out again to Mark V. Hurd. Yet in both cases she has become a strong supporter of the new CEOs.

THOUGHTS ON HP'S CEOs She remains friends with Fiorina, whom she sees every few months. But she says Hurd's operational focus is what HP needs now. "I think Mark is a great CEO," she says.

FAMILY Married for 20 years to Tom Livermore, a former packaging industry executive. Their daughter is a competitive equestrian, whose horse-show photos adorn her mother's office.

in the corporate business could help Livermore win over the naysayers. She may even get another shot at the chief executive job, although Hurd, at 49, likely will hold the post for a good number of years.

Livermore had an inauspicious start in her current job. She took over the corporate computing business in early 2004. Just three months later, in August, it reported a disastrous quarter, causing HP to miss its earnings estimates by 33% and pushing the company's stock down 15%.

Out of that crisis, Livermore has helped forge a comeback. Within days, she instructed HP veteran Scott Stallard to set up a war room to begin addressing the unit's many operational problems. Over the months that followed, she worked closely with a seven-person team to identify and improve 15 key weaknesses—everything from how HP worked with distributors to how it pulled together bids for customers. One accomplishment: HP established an Integrated Bid Desk that reduced the time it took to generate prices for complex corporate deals from two weeks to one day.

The improvements couldn't save Fiorina, though. She was pushed out in early February of last year.

As the company searched for a new chief, Livermore headed out to talk with customers. In March she visited four large Wall Street firms and was struck by the

problems these big tech buyers were suffering from. "Every one of the CIOs was complaining that while their spending on tech equipment was declining, their spending on operations—mostly labor—was increasing an average of 10% per year. They were pleading for ways to automate more," says Livermore. "They all believed HP was a company that could help them."

From New York, Livermore traveled to Phoenix, where 80 of HP's top researchers had gathered for an annual technology confab. At the gathering, which is structured like a trade show with demonstration booths, Livermore saw a series of technologies that could help the CIOs she had just met on Wall Street. She pow-wowed with Shane Robison, HP's chief technologist, and his staff. Together, they hatched a plan centered on creating the "next-generation data center."

Hurd came on board later that month, on Mar. 29. In their first meetings, Livermore urged him to slash HP's cost structure, to boost profits and clean out bureaucracy. She also encouraged Hurd to improve HP's sales effort by investing in software tools to help salesmen analyze deals more quickly, and by promoting sales vets to run more of HP's businesses.

In all of these cases, she got her way. In July, Hurd laid off thousands and gave Livermore and her fellow division chiefs more control over their respective sales and marketing efforts. Soon after, she accelerated plans to hire more storage server salespeople and implement a new compensation plan to boost sales software, including the next-generation data center technologies. The once-irregular HP is also hiring and promoting executives to fill key posts. Among others, Steve Smith, a hard-driving former Electronic Data Systems Corp. salesman, runs the \$15 billion services business.

BLOWING HP'S HORN

THE PAYOFF CAME in November, when HP showed investors surprisingly strong results. The corporate computing business was the real shocker, with the storage and server unit posting operating earnings of \$405 million, about three times the total a year earlier.

By December, the normally hyperbolic Hurd was ready to crow a bit. At a packed meeting of financial analysts in Manhattan, he said Livermore's division would lead the way toward a "lights-out" data center. "If you look at our raw technology, I don't think there's another company in the world that has a lead on HP," he said.

A growing number of analysts think Livermore's business is back on solid footing. Merrill Lynch & Co. and Richard Farmer predicts the unit will see operating profits rise another 50% this year, to \$3 billion, while revenues will increase to \$35.1 billion.

But can HP become a leader on par with IBM, setting the trends in technology? That's a separate question. "The

company is in the process of turning around, but I wouldn't hand them the keys to the kingdom just yet," says Goldman Sachs & Co. analyst Laura Conigliaro.

Livermore recognizes that both she and HP have their doubters. But she believes time is on their side. "The fact is, there's no one better in the world at doing customers design, build, and manage data centers,"

she says. "We have not proudly or loudly enough put that stake in the ground that we will." The company's future—its own—may depend on it. ■

The dream is to turn HP into the leader in the technology industry

BusinessWeek online For a Q&A with Hewlett-Packard's Ann Livermore, go to www.businessweek.com/extras

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Google: Searching For an Edge in Ads

Click-throughs are a hit. Now the search giant is chasing radio, print, and even TV



BY DAVID KILEY

FOR THOSE BUYING ADVERTISING these days, the first stop for many is Google. Already the leader in Internet search, the Mountain View (Calif.) company is quickly growing new media tentacles—from buying and selling magazine and newspaper ad space to last week's announcement that it's entering the radio advertising and TV ad placement isn't far off.

To learn where the Internet search giant is headed, just sit in on a recent session with Google sales folks and one of its advertisers. It's a frigid, snow-swept afternoon in Malvern, Pa., at the campus mutual fund giant Vanguard. The meeting begins with a discussion of the firm's simple text ads that appear alongside the right side of a Google search and link Net surfers to Vanguard's homepage. That strategy is clearly a slam-dunk: Vanguard in November paid the least per keyword of any of its rivals yet scored the best rate of click-through from ads to its Web site. The Vanguard team is grinning.

Then the contagion kicks in. The Google model has opened up so many possibilities for reaching consumers that the two sides at the cramped conference room table are acting like they are rowing the same scull rather than buying and selling. Way ahead of schedule, they quickly onto new Google products. Piquing Vanguard's curiosity: a series of banner ads on a network of small audience sites tailored for the client by Google and a new product in which consumers, if Vanguard bites, click an on-screen icon to make an Internet phone call to a mutual fund adviser.

COUNTING CLICKS

THIS MEETING LASTS about 90 minutes, brief these days by Google standards. Traditional sales chief Tim Armstrong's planning sessions can last a few hours, and some clients are asking for a "summary," a half-day deep-dive into all the Google's. As Google's media footprint expands, Armstrong, 35, seems to be wearing the biggest sneakers, with his estimated 2,500-person sales and marketing unit. Based in Google's Times Square offices in Manhattan, Armstrong's group will help bring net ad revenue to an estimated \$6.5 billion for 2006

ARMSTRONG'S ARMY
Google's ad boss with a few of his staffers in New York

from just \$2 billion in 2004.

Google's popularity with advertisers is fore-

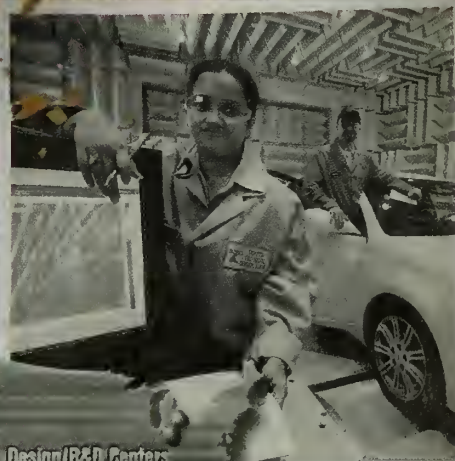


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based on cost and accountability. Its simple text-ad service, called AdWords, enables marketers literally to count how many Net surfers click from a Google text ad to the company's Web site. That ad model is increasingly preferred to traditional TV, print, and radio ads that have difficulty quantifying how many people are actually paying attention. But while Google has gone from search engine to media octopus in less than a year since expanding its reach, it hasn't lost all the feel of an Internet startup. Says a slightly self-effacing Armstrong: "One of our challenges is just figuring out the right way to sell and even who and how many should be in the room when we go see a client."

For the Vanguard meeting, there are just six people—two from Google, two from Vanguard, and two from Vanguard's ad agency, Avenue A/Razorfish. It turns out that with AdWords, Vanguard in November spent less than 50¢ per click, one-tenth that of some rivals, and 14% of Net surfers exposed to the ad clicked through to its Web site. That performance beats the response rate from a typical direct-mail effort, for example, of about 2%. And it's why Vanguard upped its Net ad spending by 33% since 2003, to \$12 million last year, while it cut every other media category, according to TNS Media Intelligence. Vanguard spent \$40 million total on ads last year, says TNS.

BLOG-WARY

NEXT UP: HOW TO better reach financial planners. So Google pitches the company a "site targeting" program in which its banner ads could appear on a handpicked network of news sites, blogs, and even message boards. But Vanguard is wary of throwing up its logo and Web site link next to unpredictable content like blogs. For now, Google looks out for advertisers with its own eyeballs. But ad sales manager for financial services Jerry Canning lets it be known that Google is working on an algorithmic lever that advertisers might pull in the future to keep their ads from running next to blue or just pinheaded consumer-generated postings. In Vanguard's case, it might be someone mouthing off about its fees or an ill-informed analysis of college savings plans. "We're in the trust business, so we like to examine the content adjacent to our ads," says Sean Haggerty, Vanguard's marketing chief.

Its one-two punch of low prices and concrete results thrills marketers

The Ad World According to Google

The search engine generated over \$4 billion in net ad revenue in 2005. What Google's up to:

NOW MAKING MONEY

ADWORDS Advertisers bid for keywords that bring up their text ads—and more recently, graphic image ads—next to search results and as sponsored links. Companies generally set a cap on what they will spend per week or month for each consumer to click on their ad.

SITE TARGETING Google helps an advertiser choose Web sites based on the frequency of keywords on the site for its banner ads. The price is based on cost-per-thousand page viewers.

JUST IN

PRINT ADVERTISING Google buys print ad space in magazines and resells it to its advertisers.

GOOGLE BASE It allows anyone, including companies, to post searchable content, from job listings to product descriptions of new stuff, like inventory overflow at Sears, or, for individuals, unwanted wedding gifts that might have otherwise ended up on eBay.

COMING SOON

TV/RADIO ADVERTISING Google just bought radio ad buying firm dMarc Broadcasting and is examining the TV ad buying business.

CLICK-TO-CALL A telephone icon appears next to a text ad or sponsored link, indicating a toll-free number Google will dial for computers equipped with Internet phone service.

Data: BusinessWeek

Vanguard is also interested in RSS feeds (for really simple syndication) and podcasts, to which retirement planners subscribe. It's a delicate balance, though, between putting up an effective ad and intruding on the Web surfer's self-directed content, worries Vanguard's director of marketing Marilyn

Harvey. Such concerns surprise Armstrong. He's fascinated that, overall, many of the same advertisers that increasingly want to jam their brands into TV shows "are as sensitive as we are about polluting the Web experience."

Another of Google's new products now in the testing phase surfaces: Click-to-Call. This allows people with Internet phone service to connect to, say, a Vanguard call center via a mouse-click. Vanguard worries, though, about driving traffic to its centers during hours when staffing is low. The Net, after all, is a 24/7 medium.

Google's Canning sure Harvey's phone service can targeted both by geography and time day. Again, Harvey interested but w. She doesn't want drive phone c which are expen to handle, for gen inquiries. "We our Web site to most of the wo she says.

Still, Vanguard Haggerty is al giddy with all possibilities. "As as we are, we a Web and 1-800-n ber company. have no bricks mortar, so our site and call cer tell us what wo he says. He m even hike his r small TV ad sp ing, but only afte and the Inte mesh, as Google pects, in the sumer's living ro No wonder Google examining buyin TV time and rese

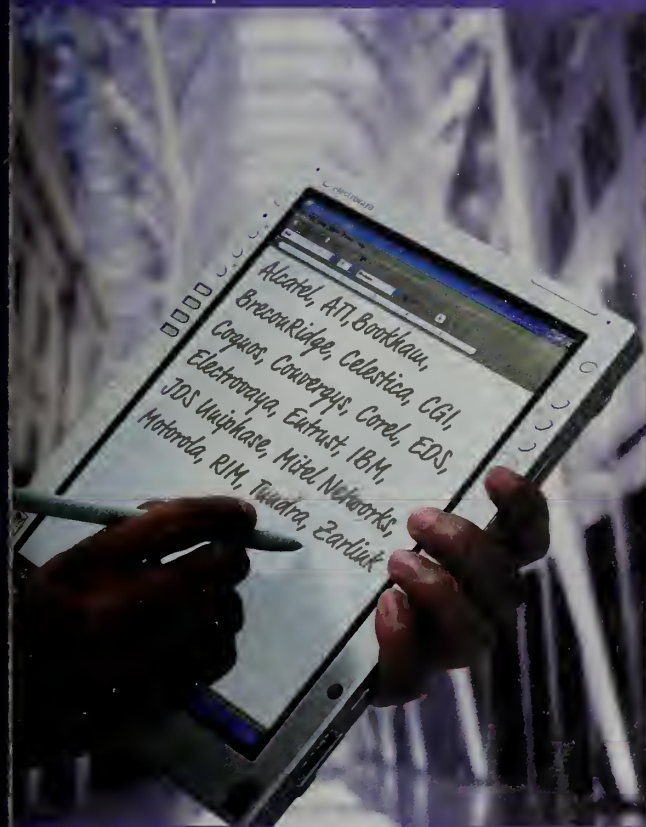
it to its advertisers.

But such ventures progress slowly. Especially such recent moves as reselling magazine ad space and offering shows like Star Trek via broadband. "People think it's a no-brainer for us, it takes time to do these things right," says Armstrong.

Still, the ad world has certainly turned on its ear since the distant (way back in 2003) when auto marketer booted Armstrong and his staff out of pitch meetings because text ads couldn't show pictures of cars. Now some General Motors ads actually link a GM brand name with the search engine for the instant cachet, calling on consumers "Google Pontiac." Says GM sales marketing chief Mark LaNeve: "I'm touting Google, frankly, because it's for credibility and consumer empowerment, and we like the association." calls Armstrong: "I remember one Detroit who cut us off, saying we couldn't understand advertising." Now it's the advertisers that are busy trying to understand Google. ■

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More Than Meets the Eye

Companies may soon be forced to put their unfunded pension and other retiree benefit promises on their balance sheets

BY NANETTE BYRNES

DESPITE PLOWING BILLIONS in borrowed funds into its pension plan, General Motors Corp.'s worldwide retirement schemes still had a shortfall of \$7.5 billion at the end of 2004. On top of that, the auto maker had a \$57 billion gap in its retiree health-care plans. Investors must delve deep into GM's 196-page annual report, to footnote 16, to learn all this. It's certainly not clearly laid out on the balance sheet, where much of GM's retiree obligations are not accounted for at all.

But if accounting rulemakers have their way, GM's \$65 billion in unfunded retiree promises—\$20 billion more than its cash and investments—will be front and center on its balance sheet as soon as next year. Encouraged by the Securities & Exchange Commission, the Financial Accounting Standards Board is moving to bring more transparency to pension and health-care benefit accounting. "The degree of underfunding in these plans has become more and more visible over the years," says Robert H. Herz, chairman of FASB. "We thought we needed to do something quickly to get these numbers on the balance sheet."

Once that's done, FASB will undertake a more ambitious reconfiguring of the way pension and health-care promises are tallied. This second phase could take several years, FASB says. Executives worry it could eventually result in companies having to reflect volatile swings in such liabilities in their earnings reports.

Herz may face a big backlash from business. Standard & Poor's calculates that companies in its 500-stock index owe \$442 billion more in retiree benefits than they have put aside. Of that amount, some two-thirds, or almost \$300 billion, isn't reflected on balance sheets, according to Morgan Stanley. Indeed, Morgan Stanley calculates that if companies put



full pension and other retiree obligations on their balance sheets, reported would soar 40%, to \$1 trillion. As a result, says Howard J. Silverblatt, S&P's chief index analyst, FASB's move "is going to make [the controversy over exercising] options look like nothing."

It isn't going to have to stomp up \$1 billion all at once. Its pensions continue with Employee Retirement Income Security Act (ERISA) funding requirements. Legally, health-care promises must have to be prefunded. Nor would a downgrade of debt come into play, as debt rating agencies already factor these obligations into their ratings. GM Vice-Chairman and Chief Financial Officer Frederick A. "Fritz" Henderson says the proposed new rules are very complex, and GM doesn't yet know what the impact will be. But GM's shortfalls could shrink this year, given its pension plan's strong performance. GM Chairman and CEO G. Richard Wagoner Jr. would not comment on FASB's proposed changes. But he noted during an analyst meeting on Jan. 13 that GM's plan is now overfunded by \$6 billion after earning a 13% return on its investments in 2005, a \$3.5 billion gain over 2004. A health-care deal recently signed with the United Auto Workers will cut that liability by \$15 billion, according to GM.

CHANGING RATIOS

STILL, THE INITIAL change in FASB rules could have a significant impact on how companies employ surplus cash. It will also reset a host of financial ratios, such as debt-to-equity and debt-to-book value, that loan officers, investment bankers, and investors use to evaluate companies. "Anything that affects the balance sheet in this magnitude is important," says Henry McVey, Morgan Stanley's chief U.S. investment strategist.

The changes could have a major impact on how companies use surplus cash

Companies most affected will be older ones that are often unionized and have large pension plans and substantial retiree health-care commitments. For example, Boeing Co. could see \$18.6 billion in obligations added to its balance sheet under the proposed rules. Its health and pension plans are still open to new employees. But even companies that moved to freeze their plans, most recently IBM, will add a lot of red to their balance sheets if they are underfunded.

The logic of putting these shortfalls on company tabs is simple. Companies have to make good on any underfunding that isn't compensated for by better-than-expected investment returns. And that won't be easy. S&P calculates that seven companies in its 500 index have unfunded retirement liabilities exceeding 25% of their total assets. At the top of the list: appliance giant Maytag (47%), Goodyear Tire & Rubber (38%), and Navistar International (35%), maker of trucks and engines. For Lucent Technologies Inc., which has \$17 billion in assets on its corporate books and pension plan assets of \$28 billion, "you can argue that the pension plan is as important as the operating company itself," says Credit Suisse First Boston accounting analyst David Zion.

For many, it's not the pension that hurts them the most. S&P figures retiree health plans are only 22% covered by assets, vs. 88% for pensions. The reason: Besides not being legally required to fund health-care costs, companies don't get the same tax credit for them as they do for pensions. An analysis by accounting expert Jack T. Ciesielski, publisher of the *Analyst's Accounting Observer*, shows that more and more liabilities are being hidden off balance sheets. He found that for 276 S&P 500 companies such underfunding rose 30%, to \$318 billion, from 2001 to 2004, while the amount making it onto balance sheets barely budged, at around \$200 billion.

Since many plans are being frozen these days, critics of change argue the accounting issue is fast becoming moot. "It's a dinosaur," says Colleen Cunningham, president and CEO of Financial Executives International, an association of corporate finance officers. "Shouldn't [FASB] be spending time on other things that might make a bigger difference?"

Executives seem especially concerned about the second stage of FASB's overhaul of the rules. Moving unfunded liabilities from a footnote onto the balance sheet is little more than a "geography question," says Gregory J. Hayes, accounting and controls vice-president for United Tech-

A Big Hit to Balance Sheets

Large companies are carrying nearly \$300 billion in pension and retiree health-care liabilities off their balance sheets....

COMPANY	OFF-BALANCE-SHEET LIABILITIES TO RETIREES (BILLIONS)*
General Motors	\$62.4
Boeing	18.6
Verizon	16.8
IBM	16.1
AT&T	14.8
General Electric	8.2
United Technologies	4.5

Data: Morgan Stanley, company reports

...Now, accounting rulemakers want any underfunded amounts back on balance sheets, where they'll weigh heavily against corporate assets....

UNDERFUNDING AS % OF ASSETS*	
Maytag	47%
Goodyear	38
Navistar	35
Allegheny Technologies	33
Rockwell Collins	31

...and companies' market caps, as soon as the end of this year.

UNDERFUNDING AS % OF MARKET VALUE **	
General Motors	529%
Ford Motor	305
Visteon	240
Goodyear	213
Dana	207

*Most recent 10-K number **Dec. 9, 2005

Data: Standard & Poor's

nologies Corp., which has a pension underfunding of \$3.1 billion and an estimated \$4.5 billion in off-balance-sheet retiree liabilities. "We don't like it, but it's no new news." More worrisome to Hayes is the possibility that FASB might require liabilities and assets to be adjusted to reflect current market values. For his \$15 billion fund, a 1% change could add (or subtract) \$150 million in income.

Such volatility frightens financial executives, and many would prefer to stick with today's convoluted accounting. "Our concern is that the constant state of change at FASB makes it harder to understand the financial statements," says Hayes. "Our goal is to make [them] more transparent." Which is just what FASB hopes its changes will do. ■

—With David Welch in Detroit

This Bud's for Warren

Buffett and other contrarians are betting on Anheuser-Busch

BY ADRIENNE CARTER

INVESTORS USUALLY SALIVATE over a stock when they hear that Warren Buffett's Berkshire Hathaway Inc. is buying. But Buffett's golden touch hasn't worked for the King of Beers. Since late 2004, roughly when Berkshire started loading up on shares of Anheuser-Busch Cos., the stock has fallen around 15%.

It's easy to understand why investors haven't had much of a thirst for Budweiser. Beer now represents less than 56% of the alcohol business, down from 60% a decade ago, according to industry publication *Beer Marketer's Insights*. And the aggressive marketing tactics of distant No. 2 Miller Brewing Co. have given the nation's top brewer a headache. AB's volume sales fell 1.8%, to 101.1 million barrels, in 2005, and Wall Street expects the company to announce an 11% earnings drop on Feb. 1, its first annual decline since 1995.

Contrarians like Buffett think AB, with its marketing muscle and dominant position, is a bargain. They might be right. The stock is cheaper than it has been in nearly a decade, changing hands for just 17.0 times trailing earnings, vs. a 10-year historical average of 21.6. The stock's traditional discount to the Standard & Poor's 500-stock index has grown from an average of 15% over the past 10 years to 23%.

Glenn H. Tongue, a managing partner with the private investment firm T2 Partners LLC, estimates the company's earnings per share will reach \$3.50 within three years, up from analysts' consensus estimate of \$2.39 for 2006. Assigning a multiple of 17 times those earnings, he figures the

stock is worth closer to \$60 than the \$43 or so it fetches now. "If you look past short-term deviations, Bud has a compelling economic model with high returns on invested capital and free cash flow in excess of net income," says Tongue, who counts Bud among his top 10 holdings.

BUD BRAND POWER

ANHEUSER'S CASH FLOW is formidable. Its operations, fueled by a huge domestic business, throw off \$2.7 billion a year. Anheuser has a history of using cash to reward investors with stock buybacks and dividends. It pays a dividend yield of 2.42%, vs. 1.87% for the Standard & Poor's 500. That and AB's buyback histo-

ry are convincing some to wait around see if Buffett's bet pays off.

What the doubters forget, say AB's porters, is the power of the Bud brand. AB's many products still account for 48.6% of U.S. beer sales, and some analysts see the company gaining market share in 2006. The next two competitors, Miller and Molson Coors Brewing Co., have only a 29% share of the market combined. Anheuser's scale means it can command loyalty from its exclusive distributors, who drive nearly 70% of Bud's sales. "The franchise and distribution network are extremely valuable, and they're going to disappear," says Stephen Goddard, manager of New Market Fund, which has 3% of its assets in Anheuser. Recent price cuts and stronger promotional efforts in bars have helped stabilize sales. In the fourth quarter, AB increased shipments to wholesalers by 0.8%.

the previous year, reversing

a yearlong trend of declining sales.

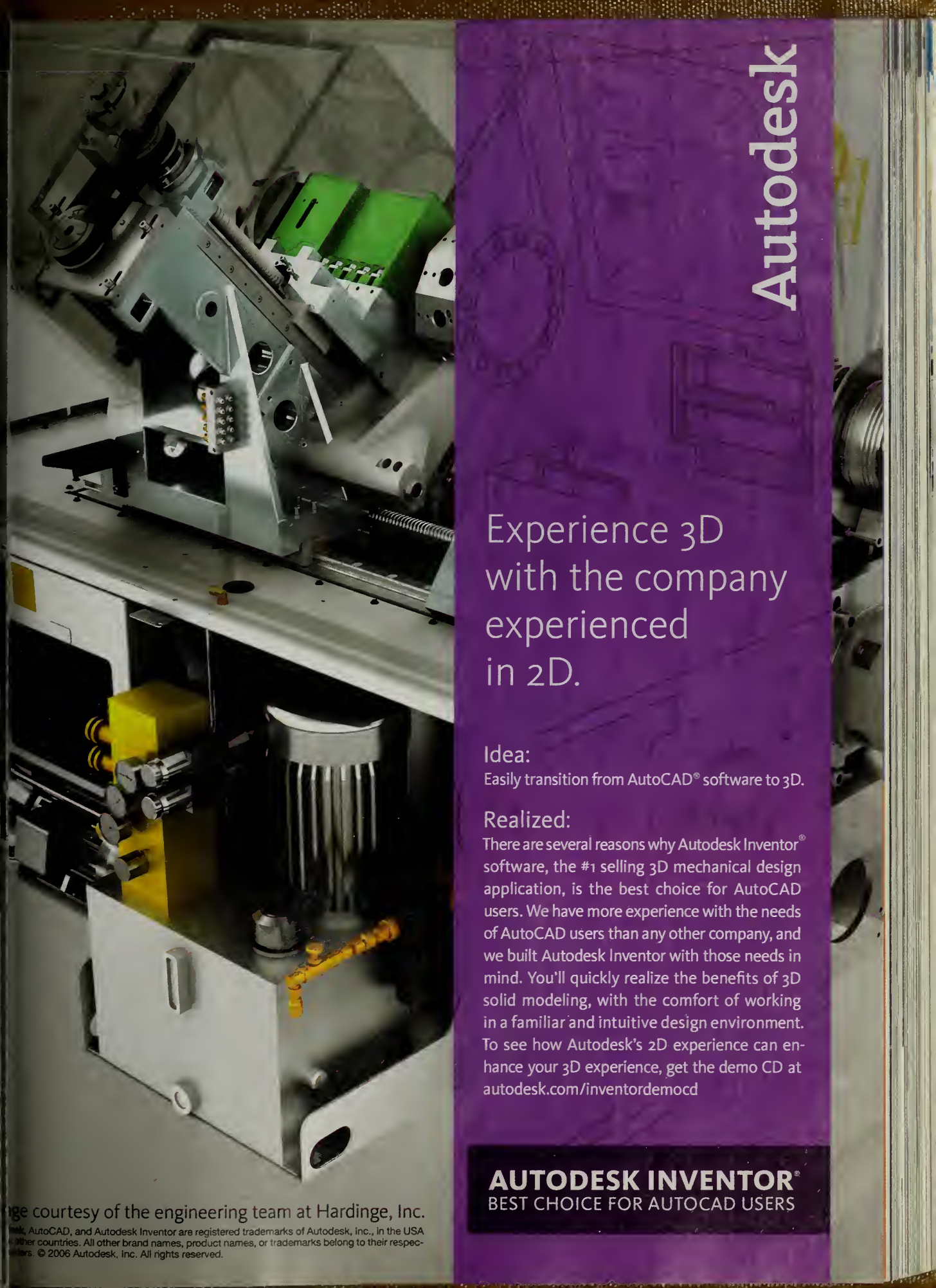
uptick has some investors thinking that Anheuser-Busch turned the corner.

Many investors view AB's venture into fast-growing markets in Latin America and China as a bonus. It's a 50% of Mexico's largest brewer, Cerveza Modelo. And recently hiked its investment in China's Tsingtao Brewery Co. from 9.9% to 27%.

businesses represent just 6% of revenue right now, but position Bud in one of the hottest growth areas. China is the world's largest beer market, and it's growing

at 8% a year, compared with essentially no growth in the U.S. Such prospects, say Bud bulls, give investors even more reason to belly up to the bar.





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Make Your Own Kind of Music

Amoeba does, and the indie retailer is bucking industry odds and expanding

BY STACY PERMAN

IN 1990, AS MUSIC MEGASTORES were taking over city blocks and CDs were spinning LPs into relics, Marc Weinstein launched what seemed like the wrong company at the wrong time. Weinstein, who managed San Francisco's legendary Streetlight Records Ltd. for seven years, went ahead and started Amoeba Music Inc., a Berkeley (Calif.) record shop devoting half its inventory to used and rare vinyl. Weinstein wanted to make Amoeba into his ideal of the music shopping experience. "I always imagined a community-based record store where everyone celebrated the artists and the music," he says.

To do that, he and two co-founders pooled \$325,000 from loans and savings,

then took over a dilapidated 3,500-square-foot storefront used mostly by homeless people. Its first day, Amoeba took in \$10,000. "We've been busy since the day we opened," says Weinstein, now 48. "We've never looked back." Amoeba's Berkeley store is now in a 12,000-square-foot space (formerly a bowling alley); the newer Los Angeles and San Francisco stores are more than twice that size. Next, Weinstein is launching a record label and planning a Web site for paid music downloads, just as the industry is being cannibalized by file sharing.

Amoeba's success defies the industry's malaise. Its sales grew 6.5% in 2005, to \$60 million, even as industrywide album sales fell 7.2%, according to Niel-

WEINSTEIN
Amoeba's three stores boast 2.5 million titles

sen SoundSc
Weinstein's
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are not influen
by industry s

dards or norms," he says. Instead of focusing on hit makers, Amoeba has a critical mass across genres that includes soul and jazz but also Hungarian folk and Pakistani *qawwali*. Amoeba carries 2.5 million titles, including DVD. 60,000 in a typical big-box music store.

That selection inspires cult-like devotion. Marlon West, a Los Angeles special effects animator, took empty suitcase twice-yearly Amoeba pilgrimages until Hollywood store opened. "I'm just that I haven't sustained complete financial ruin because of it," he says, still in awe the time he found a complete box set of trip-hop artists Massive Attack at the Francisco store.

More than selection distinguishes Amoeba. The company doesn't take display allowances from record labels; the CDs that get displayed are the staffers enjoy. Those 520 staffers love their stuff: Before being hired, each must listen to a random box of CDs, brief Weinstein on the artists. Employees make between \$9 and \$20 an hour. Amoeba paying half their health insurance premiums after six months. Two years Amoeba foots the entire bill.

To launch the record label and Weinstein and his partners will be trading on their credibility as music zealots. "You can easily make money selling 50 units," says co-founder Dave Price, "because Amoeba will spend much less than the majors on manufacturing, distribution and marketing. Aram Sinnreich, a partner at Los Angeles media consultants

BUSINESSWEEK
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Research, agrees. "The majors have developed a perverse economy of scale," says. "They are duty-bound to spend and sell an ever-

escalating volume." Amoeba's first effort will be an album of unreleased material by late country rock pioneer Gram Parsons and works by emerging Gypsy jazz artists. Amoeba is more tight-lipped about its Internet strategy. The co-founders say they'll spend \$10 million to \$20 million over the next 18 months developing the line presence. They think they can create something combining their broad knowledge with a superior buying power. After all, Amoeba has already done it well dancing to its own beat. ■

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Three-Minute Moguls

Edgy filmmakers are forging an online Hollywood. Some are even making a living

BY RONALD GROVER

CAN A CONVERTED BARSHOP off a main drag in Santa Monica, Calif., really be the new epicenter of entertainment? Evan Spiridellis, 31, a director, takes his spot in front of a computer on this December afternoon as his team of twentysomething computer animators puts the finishing touches on his latest creation, *2-0-5*. The two-minute film is a none-too-subtle lampoon of President George W. Bush's 2005 lowlights. Set to a banjo rendition of *Auld Lang Syne*, the short features a marionette-like Dubya bouncing from one

calamity to another singing "there's a special investigator after my friend Karl." Along with his 34-year-old brother, Gregg, Spiridellis runs JibJab Media Inc., a onetime commercial animation house that first became an Internet hitmaker with the 2004 election spoof *This Land*. Now, feverishly working his computer's mouse as the President tiptoes sheepishly through Iraq, Evan is rushing to make a deadline: Jay Leno wants to see a finished version for *The Tonight Show*.

By the time *2-0-5* aired on NBC on Dec. 15, the film was already on its way to becoming an Internet smash. "We were seeing a huge spike in traffic," says Rob Ben-
nett, product manager for video, TV, and

movies at MSN, which licensed JibJab's short to be shown on the online service. Within two weeks, about 2 million additional folks watched it direct from JibJab's Web site, says Gregg Spiridellis.

JIBJAB BROTHERS
Evan and Gregg Spiridellis started their commercial animation business in 1999.

Those may not be the blockbuster numbers of, say, a *Spider-Man* or *The Lord of the Rings*, but six years after the Internet bust dashed hopes that original movies and shows would fly in cyberspace, commercial production is back. And it's not just fueled by Hollywood suits and big-budget directors like Ron Howard and Tim Burton who crowded the Net in 1999. Now, a small army of computer jocks from Santa Monica to Brooklyn is quietly creating a New Hollywood by conjuring up hundreds of short bursts of animation or live-action entertainment from second bedrooms or kitchen tables.

AD MAGNETS

EVEN THOUGH THE online flicks are crass, irreverent, even downright funny, companies such as Ford, Miller Brewing and AT&T are taking notice, placing ads in the films themselves or running next to the videos. Going a step further, companies eager to connect with the younger audience are hiring these filmmakers to create commercials.

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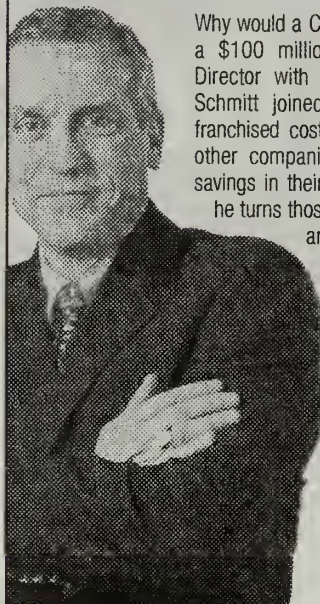
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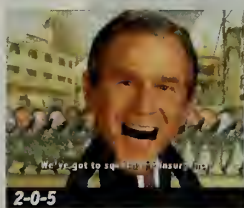
**ARCHITECTURAL
RECORD**

Entertainment On the Fringe

ning a business instead of a pas-
" says Frank Dellario, a co-founder of
dyn's ILL Clan Productions, which
reated shorts for MTV2 and other
nels and commercials for Audi.
proved broadband speeds and pene-
n, as well as growing demand for
nt for wireless devices and
consoles, are giving the
a boost. Soon, plans for Int-
t protocol TV (IPTV) by giants
oogle and Yahoo!, which lets
ers see shows on both TV and
uters, could create an even
r opening. In fact, edgy fare is
ely what's connecting with
gers, college kids, and, in-
ngly, older folks getting hip
he Net's vast offerings.
re's a wealth of cool content
ere that plays well with our
s," says David Cohn, general
ger of MTV2, which airs the
s on its show *Video Mods*.
with any kind of fringe me-
hese new filmmakers pride them-
s on producing their work on the
Net. Three-minute shorts can cost as
little as \$1,000 and rarely more than
\$5,000 to produce. They often star girl-

Alternative **Hollywood**

As the demand for video on the Internet explodes, entrepreneurs are delivering short, offbeat films and programs—and drawing a loyal following. A few of the hot startups:



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THE FARE Machinima that uses 3D video-game technology

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ICEBOX

www.icebox.com

THE FARE Animated shorts

NOW SHOWING Soon to be made into a movie for Paramount



MONDO MEDIA

www.mondomedia.com

THE FARE Animated shorts

NOW SHOWING On DVDs, cell phones, and gaming-TV channel G4



friends or feature the voices of out-of-work comedians. And because it costs so little to get started—a computer, some software, and a digital camcorder—there's no shortage of counterculture

Spielbergs flooding the Net. Atom Entertainment, founded in 1998 and today the reigning site of this category, has 6 million monthly visitors to its various Web sites that act as a distributor for the films,

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much like a cable channel. Atom pays as little as \$500 per short, say online producers. But the site also gives content creators a small cut of the ads preceding their flicks. That can mean popular shorts can make more than \$200,000, says Atom Entertainment Chief Executive Officer Mika Salmi.

BOTTOM DOLLAR

STILL, IT'S A TOUGH WAY to make a living. The hippest Web sites of the moment, like MySpace.com, purchased by News Corp. last summer, build communities of young videophiles by offering viewers a chance to show their work. That free content drives the price down for even the hottest pros cranking out films for the Web. "It has become like independent filmmaking," says Internet investment banker Michael Montgomery. "The good ones will get attention and money. Lots of others get nothing." It has also created a rarity among the online crowd: bidding wars. Last year, JibJab left AtomFilms to jump to MSN after the site agreed to host JibJab's advertising on its servers.

Internet filmmaking also serves as a showcase for directors eager to hit the big screen. Jason Reitman, the 28-year-old son of *Ghostbusters* director Ivan Reitman, says he was able to raise money for his upcoming independent film, *Thank You for Smoking*, in part because of the attention he got from three live-action films he made for AtomFilms. Icebox Inc. is producing one of its shorts, *Queer Duck*, into a full-length movie for Paramount Pictures Corp. More telling, Creative Artists Agency Inc., which represents such directors as Steven Spielberg and Robert Zemeckis, now represents the JibJab brothers.

Some of these newbies, however, say it's best to keep some distance between the old and new cultures. By steering clear of large studios, John Evershed, CEO of Mondo Media, says he has gotten better deals from smaller middlemen to distribute DVDs and merchandise based on Mondo characters. Its hit short, *Happy Tree Friends*, in which cute critters are often torn to pieces, has sold more than 500,000 DVDs through stores like Blockbuster and Best Buy. And its stickers, key chains, and plush toys are big sellers in retail chains like teen-centric Hot Topic. "Large media companies have their own way of doing things," says Evershed, "and it's not always the right way for us." Now there's a creed for the alternative Hollywood. ■



Would You Recommend Us?

That simple query to customers is shaking up planning and executive pa

BY JENA MCGREGOR

IT WASN'T EXACTLY THOMAS Edison and the lightbulb, but for Peter McCabe, it was a eureka moment all the same. In the fall of 2004, McCabe, chief quality officer for General Electric Co.'s health-care business, read a *Harvard Business Review* article recommended by a colleague. It suggested companies measure customer loyalty by asking one simple question rather than relying on lengthy satisfaction surveys: "On a scale of zero to 10, how likely is it that you would recommend us to your friends or colleagues?"

The article showed that "net promoter scores," which measure the differ-

ence between the percentage of customers who give high responses ("promoters") and those who give low ("detractors"), correlate closely with company's revenue growth. Promoters are defined as customers who give a company a 9 or 10, while detractors are those who give a 0 through 6. Customers who give a 7 or 8 are deemed "passively satisfied" and aren't calculated in the final score. The article's finding stopped McCabe in his tracks. "Wow, this is kind of perfect," he thought.

McCabe and others at the fast-growing metrics-driven company had been looking for a better way to measure customer loyalty. At the time, some of GE

care's units were using traditional customer satisfaction questionnaires as a gauge. But those indicated only vague feelings rather than the more telling action of praising a product to a friend—and they didn't track with repurchase rates. As a result, such surveys often got the brush-off from employees who saw them as a "hobby" of the marketing or quality-control department, says McCabe.

He and other GE Healthcare executives quickly rolled out net promoter scores in place of the satisfaction sur-

some divisions were using. "It was a hold 'em' kind of thing," he says. "I went all in." Twenty percent of managers' bonuses were tied to the scores, which closely tracked sales growth. Then, in January, 2005, members of McCabe's team shared the idea at GE's annual global leadership meeting in Boca Raton, Fla., where CEO Jeffrey R. Immelt greeted the approach with enthusiasm. As a result, in all GE businesses must report net promoter scores for the first time. "I have no doubt that this will be as big and long-lasting for GE as Six Sigma was," says McCabe of GE's vaunted and much-mimed quality system.

With rhetoric like that, it's no wonder net promoter scores are becoming a popular and, many say, powerful way to ensure customer loyalty, drive compensation, and flag troubled products. By ask-

ing customers whether they would put their own credibility on the line by recommending a company to a friend, net promoter scores, say fans of the concept, are truer indicators of loyalty and future behavior and, therefore, sales growth. American Express Co.'s U.S. consumer-cards president, Jud Linville, calls the scores a "beacon." Management and information technology consulting firm BearingPoint Inc. is considering tying bonuses to the scores after it found that clients that give high net promoter scores also show the highest revenue growth. Software maker Intuit Inc. is even reporting its scores in conference calls with analysts.

The approach is gathering steam at a time when CEOs are increasingly focused on getting closer to customers. It also plays into the executive lament that loyalty management programs, which track customer retention, are

among the most ineffective tactics in their toolbox. Pair that with mounting recognition of the power of word of mouth and social networks, and it's easy to see why buzz is building. There's even a book on the horizon: *The Ultimate Question* by Fred Reichheld, founder of Bain & Co.'s loyalty practice and author of the article that piqued McCabe's interest, is due out on Mar. 2.

LOOK FURTHER

STILL, REICHHELD'S concept is controversial. Many in the customer satisfaction industry say it is facile, and they worry that companies will start using the analysis without doing enough follow-up research to understand what's going right or wrong with their offerings. They also question the precision of the metric. Angry detractors who rate the company a "0" on the 0-to-

10-point scale are weighted the same as uninspired customers who give it a "6." "Clearly, it's attractive to have something simple," says Claes Fornell, the University of Michigan researcher behind the American Customer Satisfaction Index, which tracks national customer sentiment about some 200 companies. "But to have something simplistic that points you in the wrong direction is not recommended, either."

As academics debate the details, managers are putting the scores into practice.

At AmEx' consumer-cards unit, for example, low scores act as a tip-off that something may be wrong. One co-branded card suffered from low scores despite high customer usage and acquisition rates. That alerted managers to probe further. They discovered a need to simplify a complex application and make card rewards match up more closely with customer

spending. The result? Net promoter scores almost doubled.

One effect of the new approach is that companies are spending more time listening to promoters and detractors. In the European unit of GE Healthcare's services business, which maintains its hospital imaging equipment, managers following up with naysaying customers found that a chief complaint was slow response times from competent engineers. So the division is overhauling its call center and putting more specialists in the field; now net promoter scores are jumping by 10 to 15 points.

McCabe says higher scores have already been linked to a greater likelihood that GE Healthcare will win new contracts from existing hospital clients. "Ultimately, it's not about the score," he says. "It's about 'focusing on the customer.'" ■

"This will be as big and long-lasting... as Six Sigma was," says GE's McCabe

PLAYBOOK: BEST-PRACTICE IDEAS

Lessons In Customer Loyalty

Interested in tracking net promoter scores? Here's how Bain's Fred Reichheld recommends using the technique:

KEEP IT SIMPLE

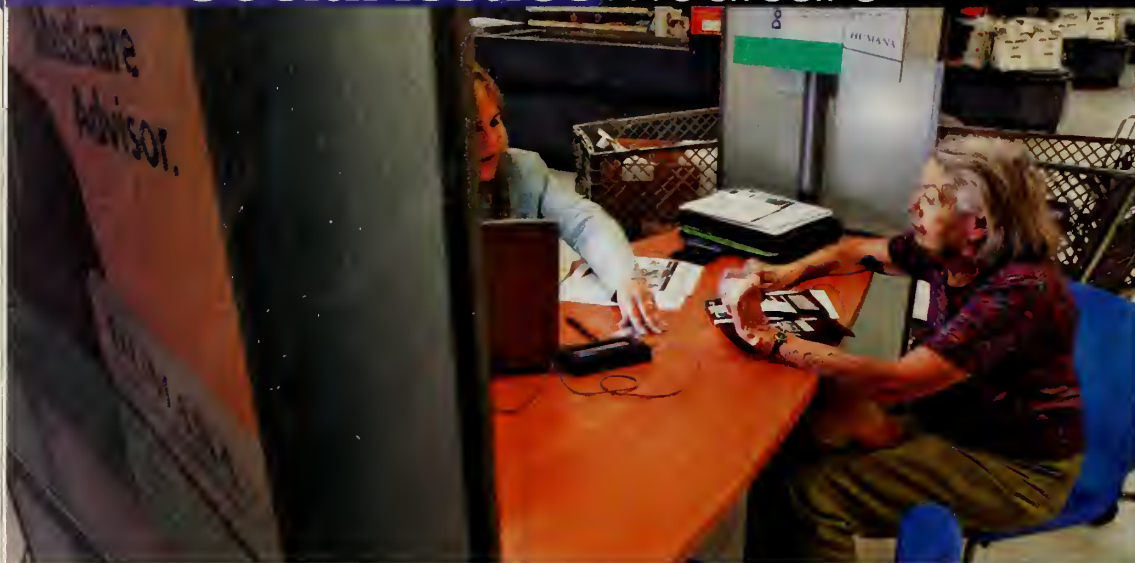
Lengthy surveys often lower the number of responses. When measuring net promoter scores, ask just one question: Would customers recommend the product? Then give them a chance to offer open-ended feedback.

WATCH FOR BIAS

If pay is tied to net promoter scores, employees may be tempted to urge customers to rate products highly. To avoid that problem, have a third party collect the data. Then audit the results.

REMEMBER THE GOAL

Don't obsess over the scores themselves. The ultimate goal, after all, is motivating front-line folks and keeping the focus on the customers' experience.



SIGNING UP A Humana kiosk at Wal-Mart

Plan A: Hook Them With Part D

Humana's low-cost Medicare drug plan is a way to lure seniors into its managed care

BY HOWARD GLECKMAN

JUST DAYS AFTER CONGRESS passed the massive 2003 Medicare Part D drug law, Vice-President for Senior Products Steve Bruckner and other top staffers at Louisville-based insurer Humana Inc. began planning. They decided on an aggressive push for a share of the trillion dollars or so Congress would be showering on the program over the next decade.

Their idea: offer dirt-cheap drug plans to grab millions of seniors. Then use the benefit as a stepping stone to a potentially richer market—Medicare managed-care plans, which cover doctor and hospital bills as well as drugs. “Forty-two million people were presented with a new opportunity to be enrolled in the drug program,” says Bruckner. “We said, ‘That’s only going to happen once.’”

Bruckner calls it an “enroll-and-migrate strategy.” To boost enrollments, Humana is paying its sales staff commissions that are twice as generous for health-and-drug plans than for drug-only policies. “Humana sees a big first-mover

advantage,” says CIBC World Market Corp. analyst Carl McDonald. “They’re saying, ‘Let’s get them into a [drug plan] at a modest margin or even no margin in Year One, then try to convert them to a [managed-care plan].’”

The move is critical for Humana. With 7 million customers, it lags far behind 25 million-member UnitedHealth Group Inc. and 27 million-member WellPoint Inc. And the industry may face lean times as growth in employer-based health care slows and a new cycle of price competition squeezes profits.

So far, Humana has signed up more than 1.1 million customers for its drug-only plan since November. Over the past year it has enrolled 273,000 new seniors in HMO-type plans. By the end of 2006, Humana expects as many as 2.2 million in its drug-only plans and up to 1.1 million in managed care.

One key is a marketing deal with Wal-Mart Stores Inc. But the centerpiece is ag-

gressive pricing. In 11 states, Humana’s premiums are below a month, far less than the \$32 average. According to health consultant Lewin Group, a 2004 drug bill of \$2,000 is just \$766 under Humana’s Standard Plan vs. an average of \$1,234 through other insurers.

Humana is even offering a \$100 bonus after low-income seniors. Washington is also aiding that strategy by boosting payments for high-cost patients, protecting insurers against losses. In addition, by automatically signing poor seniors to low-cost plans such as Humana’s, the feds are eliminating insurers’ marketing costs.

SLIMMER MARGINS

WHILE HUMANA hopes more customers will boost its leverage in price negotiations with drugmakers, its strategy could pretax returns on the pharmacy plan to 2%, half that of its rivals, estimates Carl McDonald. That’s one reason why F. Lee Turner’s eye is on managed care. Such a move may help Humana get more control over costs by pushing patients to buy cheaper generic drugs. The strategy is also taking advantage of generous government subsidies. The federal government is paying HMOs an average bonus 10% for each patient. “When the government is waving enough money at them, they are going to get in,” says B. Ginsburg, president of the Center for Studying Health System Change, a Washington research center.

Still, Humana’s dive into Medicare is risky. In the long-term deficits, Washington could scale back those subsidies. That happened in the 1980s and ’90s, when government attempts to push managed care floundered and quit the business. And Humana’s early enrollment next to the 4 million seniors

who have joined UnitedHealth, thanks to a branding deal with AARP, is a risk. Humana execs still think it is worth the risk. They are convinced that aggressive pricing today will lead to a profitable market in the years to come. ■

Humana’s plan: \$2,000 worth of drugs for \$766



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Smart Gadgets For Seniors

New high-tech devices that keep tabs on vital signs, level of activity, medication and more can help the elderly maintain their independence. **BY ELLEN HOFFMAN**

IMAGINE ROLLING OUT OF BED in the morning and dragging your sleepy self to the bathroom sink. You glance in the mirror, wince, open the medicine cabinet, and reach for a bottle of pills. But instead of grabbing your Lipitor, you take out the Tylenol with codeine. Suddenly a computerized voice tells you that you're making a mistake. That should wake you up—and get you to reach for the right container. ♪ Far-fetched as this scenario sounds, technology-services company Accenture is developing a talking medicine cabinet to help older people manage their medications and keep track of their vital signs. While it's still several years away from the consumer market, a prototype was on display at the White House Conference on Aging in Washington in December.

Other smart high-tech products, either on sale now or in the research phase, are changing the way Americans cope with the health issues of aging family members. The devices can help people better monitor and treat their chronic diseases, provide quick access to reliable medical information in an emergency, and make a

private residence safe enough for an older person to continue living there.

Take the E-HealthKEY, which became available last fall. It can store a person's medical history, prescription drug lists, contact names and numbers, and medical-test reports on a chip embedded in a rectangular unit small enough to fit on a

keychain. In an emergency, medical professionals can plug the key into the USB port of a computer to access the information. The gadget was developed by the MedicAlert Foundation International in Turlock, Calif., which also rents identification bracelets and pagers. The device costs \$84.95 plus \$20 a year for connection to an emergency response center (medicalert.org).

LIKE A BURGLAR ALARM

THE E-NEIGHBOR system builds on existing technology used in home security systems. It consists of wireless sensors programmed to detect unusual activity in a senior's house or apartment. If the system runs for several hours, for example, the refrigerator stays closed all day, the system "calls the person to ask if he or she is O.K. If the person does not respond, the system can call or send an e-mail to someone else, such as an adult child or a health-care provider," explains John Barnett, a principal at HealthSense in Mendota Heights (Minn.) company. The company plans to market E-Neighbor stan-

Cutting-Edge Elder Care

Electronics could take some of the worry out of living alone or caring for someone who does

ONLINE MEDICINE CABINET

Still years away from being market-ready, it is designed to speak up if you grab the wrong Rx.



E-HEALTHKEY

Emergency medics can plug this into the USB port of a PC to access a user's medical history, drug lists, test results, and contact names and numbers.



IN THIS SECTION:

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104 | Interest rates and estate planning

106 | Outmaneuvering student loan hikes

107 | PLUS: Two new *BusinessWeek* blogs

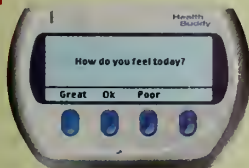


The initial cost to wire and equip a residence will be about \$300, plus \$20 a month to stay connected to emergency call center.

To see how far such monitoring systems can go, consider the one Chris Langford uses to check up on his 70-year-old

H BUDDY

...o, say, a
...ose
...lets a user
...of readings
...taps on the
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diabetic mother, Mary, at Oatfield Estates, a senior residence in Milwaukie, Ore. When he logs on to his computer, he sees a diagram of the floor where his mom lives and an icon showing exactly where she is at that moment. By clicking on screen tabs, he has access to everything from her blood pressure readings to a list of visitors she has had lately. A wireless "help" button Mary wears around her neck signals her location. Medical staffers transmit her vital signs and other data across the network. If Chris notices a pattern or event, such as a fall, that worries him, he can call the staff.

Mary has lived at Oatfield for nearly a year since her diabetes worsened and memory loss undermined her ability to

care for herself. She gave Chris permission to use the monitoring system, and the access it affords has relieved much of his anxiety about her well-being. Oatfield owners Lydia Lundberg and Bill Reed are marketing their proprietary system to other senior residences, but it's not yet available for individual families.

Researchers also are perfecting in-home devices that monitor the weight, blood pressure, and other vital signs of seniors with chronic diseases and send a report to doctors or caregivers. One example is Health Hero Network's Health Buddy, currently available only through medical providers. The 5-inch by 9-inch box is placed in the home and attached to, say, a weight scale or a blood-glucose monitor. Pushing buttons to answer questions that appear on a small display, the user can alert medical personnel to danger signs such as rapid weight loss.

SENSORS WHILE YOU SLEEP

WITH A "SMART" bed developed at the University of Virginia's Medical Automation Research Center in Charlottesville, a patient need only lie down to check and transmit medical information. Expected to be called the NAPS bed, for non-invasive analysis of physiological signals, it has wireless sensors that measure pulse rate, breathing, and restlessness. Steve Kell, a robotics-lab specialist at the center, says he sees the bed going on sale for about \$1,000 by the end of 2006. But "to be effective, there should be a caregiver in the loop" who can read and interpret the data, he says.

Does this sound like an invasion of privacy? Stephen Agritelly, director of Intel's health-systems research lab in Beaverton, Ore., says Intel studies show that many seniors will accept monitoring and prompting devices "when you take data that comes from a sensor network and feed it back in a way that helps them."

For Langford, using Oatfield's system is a no-brainer since it's not intrusive and may prevent his mother from wandering. "It's not like they have a camera on her. They just need to know where she is," he says. "I hope when I get to be her age, if I ever get into her situation, they know where I am and how to find me." ■

BusinessWeek weekend For more info and to see these products evaluated by doctors and older consumers, watch our weekly TV show, *BusinessWeek Weekend* (check your local listings), or view it at businessweekweekend.com





HDTVs Scaled Down to Size

Smaller sets fit in the bedroom as well as the come-over-to-watch-the-game room. **BY ANDREW PARK**

A YEAR AGO, JUST IN time for the Super Bowl, my pal Scott Culpepper plunked down a small fortune for a 60-in. Sony high-definition television. The rear-projection microdisplay looms like an aircraft carrier on one side of the huge TV room over his garage, which has, not surprisingly, become his friends' favorite spot for viewing sporting events.

But Scott, who travels frequently for work, bemoans the fact that his wife still

prefers watching TV in their much cozier master suite, home to a basic 27-in. tube. "I never get to watch it," he complains of his prized big-screen HDTV.

If you love it in the living room, it's time to spread high-def around the house. Smaller 32-to-37-in. sets, which run from \$1,000 to nearly \$3,000, come loaded with the same features as their big brothers, greatly improved picture quality, and handsome new designs. The best part: Prices are falling fast.

Sure, there are even smaller HDTVs. You can find them with screens as small

as 15 inches (measured diagonally). Some great 26-inchers cost less than \$1,500. But anything smaller than a 26-inch set may look like a computer monitor once you're watching from a distance of six feet or more—which may be the case in your bedroom. At the same time, a 42-inch flat screen may feel like overkill in the master suite. Besides, if you're too close to an HD set, the picture won't appear sharp.

To save space, you may want to choose a set that incorporates the requisite tuner. Take note, too, of the lighting in your viewing room. It could be brighter than the showroom where you'll view the floor model, so look for a set that performs well in lots of ambient light.

BEWARE OF GLARE

CHANCES ARE THOSE requirements are going to land you in the liquid-crystal display aisle. Flat-panel technology is brighter in bright rooms than plasma offers much higher resolution in dim rooms, meaning it will produce a sharper image and do double duty as a PC monitor. While plasmas render dark shades more accurately and offer deeper

better contrast, it's likely you'll be concerned about glare off a plas-
glass when you're trying to watch
as you get dressed in the morning.
other advantage of LCDs: At the
est sizes that are right for a second
7, they're plentiful and relatively
o. The average price of LCD sets
ing from 30 in. to 35 in. dropped
last year (to \$1,540) and should fall
more (to \$1,260) by the second quar-
ecording to El Segundo (Calif.) mar-
searcher iSuppli. "LCD is a good val-
says Paul Semenza, a vice-president
uppli. "There's an oversupply."

ke the 37-in. Westinghouse Digital
-37W1. Despite a street price of less
\$1,600, it sports smart looks, a vari-
valuable input jacks, and 1080p res-
on (1,080 lines, with progressive
s, a new flavor of HDTV that most
ufacturers are offering only in much
r and more expensive sets. You'll
bly hear about 1080p when you go
oping. In theory, the higher resolution
roduce a sharper, clearer picture in
definition and will be able to render
detail of 1080p content when it
s appearing on DVDs and TV.

ending for this feature now is a way
sure your set isn't obsolete in a cou-
years. Says Semenza: "If you want
ally future-proof yourself when it
s to HDTV, you want 1080p." Still, in
er sets, 1080p may not look much
ent from the lower-resolution LCD
ns—nor will it matter much if most
hat you're watching is standard-
definition analog programming.

wer prices have their trade-offs. The
inghouse model doesn't include a
t, so for HDTV you would have to get
-top box from your cable or satellite
any or buy a separate HD receiver,
et \$150, which lets you pick up the
dcast signals with an antenna.
e it boasts impressive features in this
Westinghouse has been selling LCD
only since 2003. It's one of a host of
me industrial names recently revived
argain electronics brands, including
ania and Polaroid, none of which has
n of a track record in their current
nations.

or peace of mind, consider downsiz-
p the 32-in. Dell W3201C, which you
buy directly from the manufacturer
\$1,699. Want to see it in person? Dell
kiosks in malls across the country
re you can get up close with its TVs.
ou can pony up for Sony's 32-in.
avia KDL-V32XBR1—as low as \$2,090
line discounters.

ny calls the Bravia line the first TVs

Wowing the Whole House

Improved performance, features, and styling—not to mention falling prices—make these modest-size high-definition TV sets perfect for places where giant-screen models would be too much.



Dell
W3201C
\$1,699

Features and picture quality set it apart from no-names



JVC
IT-37X776
\$1,888

Smart looks and connectivity, but not picture-perfect



Panasonic
TH-37PX50U
\$1,900

Outstanding and affordable plasma, but no PC input



Sharp
LC-37D7U
\$2,137

Near-plasma performance but at a steep price



Sony Bravia
KDL-V32XBR1
\$2,090

Not cheap, but tops in performance and styling



Westinghouse
LVM-37W1
\$1,600

1080p resolution for a song, but no HDTV tuner

Data: BusinessWeek, CNET.com

designed for women as well as men. Whatever the company is thinking, they're hands-down the most attractive LCDs on the market. Now that even \$29 DVD players come bathed in garish silver paint, Sony has put the emphasis back on the picture by framing the Bravia in a sophisticated matte-black case with understated stainless-steel trim. By placing the 13-watt speakers underneath the screen, Sony saves room, which helps the set fit into tighter spaces. Like all LCDs, it's slim enough to hang on the wall.

ADJUST TO TASTE

FORTUNATELY, BEAUTY isn't only case-deep. The Bravia produces a wonderfully crisp, detailed picture in HD and better-than-average analog images while offering a multitude of ways to adjust for such things as room brightness or type of program. Sony gave it a built-in HD tuner that lets you pick up the big networks' signals with an antenna, as well as a CableCard slot, which lets cable users get HD without a set-top box. That feature also is available on worthy 37-in. rivals, such as JVC's IT-37X776 (street price \$1,888), and Sharp's LC-37D7U (\$2,137). Both come in 32-in. versions, too.

Of course, for some HDTV enthusiasts, only plasma will do. They love its realistic, three-dimensional picture in their home theater and will settle for nothing less in other rooms. For them, Panasonic makes a 37-in. version of its best-selling big-screen plasmas, the \$1,900 TH-37PX50U. Plasmas in this size can be hard to find, and you won't find a better picture than the one on Panasonic's. Watching high-def coverage of the drizzly Tournament of Roses parade, I could almost feel the rain on the back of my neck.

Before you buy any HDTV set for any room, carefully consider what kind of shows you'll be watching and when, and where you'll be sitting or lying. The answers will help you avoid buying a snazzy new TV you seldom get to watch. ■

BusinessWeek weekend For more info on high def and to see many of these TVs, watch our weekly TV show, *BusinessWeek Weekend* (check your local listings), or see it on your PC by going to businessweekweekend.com



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Interest Rates and Your Estate

Even small changes can affect what you'll pass along to your heirs, so bear these tips in mind when shopping for trusts. **BY ANNE TERGESEN**

AS EVERYONE KNOWS, the ups and downs of interest rates can have a significant impact on the price of your home, the value of your investments, and what you pay for loans. But rates can also play a big role in estate planning. Indeed, when it comes to many popular types of trusts and other estate-planning techniques, even small moves in interest rates can make a big difference in what you'll be able to pass along to your heirs—or what you'll have to fork over to Uncle Sam. "It's simply a question of knowing which technique works better depending on the interest rate," says Blanche Lark Christerson, a managing director at Deutsche Bank Private Wealth Management.

If you're setting up a trust, the key interest rate is the so-called 7520 rate. The Internal Revenue Service recalculates that rate every month, and it's based on recent auctions of three- to nine-year U.S. Treasury notes (type "7520 rate" into a search engine). At 5.4% in January, this rate has nearly doubled since July, 2003, when it was 3%. As a result, the sorts of trusts that do best in a higher-rate environment—including ones that transfer real estate and benefit unmarried couples—are getting attention after years on the back burner. "It's time to sound the bell and say these strategies are attractive," says Michael Duffy, senior director at Mellon Financial's Private Wealth Management Group.

But while the 7520 rate is way up, it's still relatively low by historic standards. So estate planners say it's not too

late to get in on trusts that thrive in lower interest-rate environments. "We're telling clients to have the documents ready so they can pull the trigger before rates move higher," says M. Holly Isdale, head of Lehman Brothers Wealth Advisory group.

Of course, when shopping for a trust, your decisions should hinge not just on interest rates but also on factors such as the kind of assets you wish to transfer to heirs, the degree of control you'd like to maintain over your wealth, and whether you want to leave something to charity. Consider your age and health, too, since many trusts return their assets to your estate if you expire before they do.

Here's a look at the impact interest rates have on various popular trusts and other estate-planning techniques.

» QUALIFIED PERSONAL RESIDENCE TRUSTS (QPRTs)

THE BEAUTY OF THE QPRT is that it freezes your home at its current value and allows you to transfer any future appreciation to your heirs free of gift and estate taxes. The higher interest rates are when you set up a QPRT, the better, since this minimizes the value of the gift you make to your heirs. That, in turn, reduces the amount of gift tax you'll pay or—if you haven't already used any of the \$1 million you can shield from the gift tax—the portion of this credit you'll use.

When you set up one of these trusts, you remain the home's owner for as long as the trust is in effect—typically, about 10 years. Then, when the

trust expires, the home passes to your children.

To see how it works, suppose you're 60 and your property is worth \$1.5 million. When you put your house into a QPRT, the value of the gift to your heirs is based on the home's \$1.5 million value. But the home won't actually pass to your children until the trust expires. So, the law allows you to discount the \$1.5 million you're transferring to your kids by a current interest rate—the 7520 rate. This tells you the current value of the gift you'll be making in the future. For that 60-year-old, this discounting—at January's 5.4% 7520 rate—knock value of the gift to \$740,000, Deutsche Bank's Christerson. If the 7520 rate were 8% instead, the value would be only \$580,000.

You may be tempted to delay a trust in the hope that rates will climb. Be careful: If you don't outlive this trust, the market value of your home will be included in your estate. In part to limit this risk, couples should consider rate QPRTs, each funded with their interest in the home, says Christerson. Another risk: If your home's value drops, you can't reduce the value of the gift you've made.

Since your home will belong to your heirs when the trust expires, be prepared to move or pay rent. But rent can be an effective way to transfer more to your

Trusts that transfer homes have come back into vogue



GRANTOR RETAINED INCOME TRUSTS (GRITs)

GRITs, WHICH ALSO BENEFIT from low interest rates, are good estate-planning tools for those who want to leave money to distant relatives—not to spouses, children, and grandchildren but to nephews, and cousins. This trust is frequently used by unmarried couples when one wants to be sure the other is provided for.

In general, these trusts are funded with securities. During the term of the trust, any interest and dividends earned must be paid out to the person who sets it up. Getting something back sounds good, but people tend to fund these with securities that pay little income. Why? The more capital you can keep inside the trust, the more income will be for the heirs, says Don

Weigandt, a wealth adviser at JPMorgan Private Bank in Los Angeles. Provided you're still alive when the trust expires, the money will go to your beneficiaries without passing through your estate.

Just as with the QPRT, you'll have to pay gift tax on the portion of what you put into these trusts that's destined for your heirs. But as the 7520 rate rises, the discounted value of that gift falls, reducing the tax bill you'll pay (or the portion of your \$1 million gift tax exclusion you'll use). There's no set term for these. But if you're young, you might want to let one run a while—say, 20 years. That will save on gift taxes because the trust's current value will be discounted over more years.

CHARITABLE REMAINDER ANNUITY TRUSTS (CRATs)

SUPPOSE YOU have a big block of stock that you bought years ago at a fraction of today's price. You want to diversify that holding, but you don't want to trigger a huge capital-gains tax bill. As long as you also want to leave some money to a charity, the charitable remainder annuity trust could be a good solution.

Here's how it works. Put the stock into a CRAT and you no longer own it. But because the trust benefits a charity, it is a tax-exempt entity and so it can sell the stock without paying taxes. It then can reinvest the proceeds in a diversified portfolio.

You retain much of the benefit from the investments. Indeed, these trusts are required to distribute a fixed amount—at least 5% of their initial value—to you each year, potentially for as long as you live. Then, at your death, what's left goes to charity.

How do rising rates make these trusts more attractive?

When you set up a CRAT, you're entitled to take a tax deduction on the portion that's destined for charity. As interest rates rise, the assumption is that the trust's earnings will, too. Because the amount you get is fixed at the outset, the IRS assumes there will be more money left for the charity—and so your charitable deduction today will be based on a higher amount.

GRANTOR RETAINED ANNUITY TRUSTS (GRATs)

THESE TRUSTS fare best when interest rates are low. But if you expect an asset you own to appreciate significantly, it's probably still worth setting one up today.

To see why, consider someone who puts \$1 million of company stock into a GRAT. To avoid triggering a gift tax bill, the person who sets up the trust, say, a father, must agree to take back the entire \$1 million plus interest calculated at today's 7520 rate of 5.4% over the life of the trust.

The point? If the GRAT appreciates by 10% a year, the owner will take back the first 5.4 percentage points. But the heirs will receive the rest—or 4.6 percentage points each year, tax-free. After two years, this \$1 million trust would amass \$74,200 for heirs, calculates Stephen Parker, a wealth adviser for JPMorgan Private Bank in Atlanta. And because the owner takes back everything he gave, there is no gift tax.

If rates rise, however, the payoff declines. For example, if this same GRAT is set up when the key rate is 7.4%, it would yield just \$42,000 to heirs after two years, Parker says. One trick: If you think interest rates are heading up, set up a long-term GRAT to lock in today's 5.4% interest rate. "With rates trending up, I'm hearing

talk about five-to-seven-year GRATs," says Duffy.

»FAMILY LOANS

YOU CAN ALSO use loans to pass money on to your beneficiaries. The lower the interest rate, the better the deal. To turn the loan into an estate-planning device, rather than simply a favor to a relative,

borrowers have to invest the money in something that earns enough to repay Mom or Dad and leave a profit. They can even use the loan to buy an asset from Mom or Dad. Provided that asset earns more than enough to repay the loan, the heirs can pocket the extra appreciation. The IRS permits relatives to lend money at the "applicable federal rates" it sets

monthly. These are far below the rate commercial loans and even below the rate on a GRAT. As a result, you should be able to transfer slightly more to heirs with a loan than with a GRAT.

Current rates on family loans range from 4.29% to 4.64%, depending on the loan's maturity. If rates continue to climb, that's going to look like a good deal.

Student Loans

Outflank The Hikes Ahead

Rates are going up on June 30, but there are ways to cushion the blow. **BY AARON PRESSMAN**

COLLEGE TUITION COSTS have been rising faster than inflation for decades, but budget cutters in Congress added a little extra pain for parents and students this year. As part of a \$40 billion budget-reduction package expected to be signed into law soon by President George W. Bush, lawmakers cut \$13 billion from the student loan program.

Since much of that money subsidizes interest costs on student loans, borrowers will face higher rates. The rate on Stafford loans to students jumps to 6.8% starting on July 1, from the current 4.7%. Parent Loans for Undergraduate Students, or PLUS loans, rise to 8.5% from 6.1% currently. The borrowing limit for subsidized loans is \$23,000 for an undergraduate and \$65,000 for graduate students.

STRATEGIC MOVES

IT'S NOT QUITE as bad as it looks, however. The old rates were reset annually, while the new rates will be fixed for the life of a loan. And because the Federal Reserve Board has hiked rates for the past year, those old bargain rates were set to rise in July anyway, to 6.5% on Staffords and 7.4% on PLUS loans. The revised program also phases out a 3%



HITTING THE STACKS

Check out state loan programs, too

origination fee charged on federally backed loans, but many lenders, such as Citibank and Sallie Mae, had already decided last year to absorb the fee for competitive reasons.

You can use several strategies to cushion the blow. First, if you have already graduated and haven't consolidated all your loans—or are graduating this spring—be sure to do so before June 30. That allows you to lock in a 4.7% rate for the life of the loan. (If you're still in school, ask your

lender if you can consolidate now.) Those with kids heading back to school the fall, spend more time looking for or specialized grant programs for budding biologist or debate champion. Web site collegeanswer.com has a searchable database of more than \$15 billion worth of scholarships available every year. Visit www.collegeanswer.com/paying/scholarship_search/pay_scholarship_search. Many states also have their own loan programs, some with more generous terms than the feds'. Be sure to check both the state where you live and the state where

student attends school.

Some parents may be thinking about a variable-rate private loan in lieu of tapping the PLUS program. PLUS loans are available at a lower rate, but there are drawbacks, warns Frank Ballin, executive vice-president at Affinity Direct, a student loan consolidator. Rates on PLUS loans can rise dramatically if short-term interest rates head up further, with caps as high as 10%. If a parent dies or becomes disabled, the obligation remains, whereas with private loans, the obligation is retired.

Even with higher rates, there are ways to trim costs after graduation. Sallie Mae and other private lenders typically cut their rates by 0.25 percentage point for those who make their payments automatically out of a checking account. Borrowers who make 30 to 48 payments on time can get their rate slashed an additional full percentage point.

If you have loans made directly by the government, it may be a good idea to consolidate them with a private lender. That will allow you to take advantage of the nifty perks. ■

ED BY TODDI GUTNER

PREP

fewer IRS Freebies

YOURSELF TAX

Free and online tax-preparation services are no cost more this year. First, the Internal Revenue Service has cut back on the free software allows at irs.gov. Then, 16 private providers gave up online tax-prep services through the IRS. The program to allow taxpayers as a way to add income taxpayers to customer ranks. Under a new law, companies associated with the IRS, those filers with adjusted gross incomes of \$49,582 or less will be eligible for the services.

Top tax-prep programs also have gotten rid of the myriad rebates that cut your outlay to as little as \$10 last year if you bothered to fill out and submit up to rebate forms. Instead, the most popular versions of Intuit's TurboTax and H&R Block's TaxCut now bundle 2005 federal and state software, along with a deduction into a single box that retails for \$30 to \$70, depending on the version. Electronic filing costs extra, but TaxCut still offers a rebate to offset its \$15 fee. No worry, there are still freebies. This year, TurboTax will swap part of any refund cards from more than 50 retailers at 10% to 50% off the face value. And, if you file with TaxCut, H&R Block will help you for free if you're audited, including representing you before the IRS.

—Larry Armstrong



GOLF CLUBS

NOW YOU CAN TRY 'EM BEFORE YOU BUY 'EM

PICKING OUT NEW golf clubs based on hitting a few balls into a net in the back of the pro shop can result in expensive mistakes. But GolfClubDemo.com allows you to rent a set from TaylorMade, Nike, or four other leading clubmakers for a five-day tryout, letting you test them in real-life conditions on a course or range. GolfClubDemo's offerings include such popular clubs as the TaylorMade r7 Quad driver and Nike's Slingshot irons. The rental fee is just \$25 (round-trip shipping included), which GolfClubDemo applies to the price if you purchase a similar set that's new. The only catch: If you don't return the clubs by the due date, GolfClubDemo charges a \$5-per-day late fee—and after another seven days, it will hit you up for the full purchase price of a new club or clubs, plus a 10% restocking fee. —Dean Foust



HOT DRIVER
Five days for \$25

GS

R INVESTORS D PARENTS

BUSINESSWEEK'S Finance and Personal Finance writers are joining the blog-re. This month they are adding two blogs to the growing list at the magazine's Web site, BusinessWeek.com. It's a new personal-finance entry, *Working Insights*. On Jan. 24, *Working Insights*, an often personal account of how people balance the competing demands of job and family, makes its debut. To ensure that there are fresh insights every day, both blogs will feature contributions from a wide range of contributors. We hope you'll check them out as well.

TIME OFF

ALTHOUGH SNARLED in controversy over alleged purchases of pirated art and financial improprieties, Los Angeles' **J. Paul Getty Museum** is reopening its magnificent Getty Villa on Jan. 28 after a seven-year, \$275 million renovation. The villa features a new outdoor café, Roman-style amphitheater, and entry pavilion, designed, says architect Jorge Silvetti, to give the feeling of an architectural dig. That's fitting since the villa focuses on Greek, Roman, and Etruscan antiquities. Reservations are required (getty.edu). —Christopher Palmeri





BY GENE G. MARCIAL

ELIZABETH ARDEN COULD BE A TARGET OF PARIS PERFUMER COTY

A FOCUS ON INVESTING MAY MEAN A GREENER **WARWICK VALLEY**

PACIFICNET IS POISED TO PROFIT FROM A CHINESE TECH RUSH.

Elizabeth Arden's Allure

ELIZABETH ARDEN (RDN) is a storied name in fragrance and beauty products, but its stock isn't smelling too sweet these days. It's down from 25 in July to 20 on Jan. 18, mainly because of an October cut in its expected 2006 earnings. Predictably, some analysts have downgraded Arden. But Gary Giblen of Brean Murray, Carret sniffs an opportunity. He has upped the stock from "accumulate" to "strong buy," with a 12-month target of 26. He argues that weak December sales in Europe, which led to Arden's lowered forecast, will be offset by the success there of Prevenge, its new anti-aging cream licensed from Allergan, the maker of Botox. Arden's new Britney Spears Fantasy perfume is also a hit in Europe, says Giblen. And, he adds, Arden may be a target of perfumer Coty, which recently acquired Unilever's fragrances. Coty says it wants to be No.1 in all the segments of the global fragrance market—which means acquisitions. Based on the deal, Arden is worth 38 a share, Giblen figures. The likelihood of a buyout is stronger now, he says. Coty wants to expand in the U.S., and Arden fits the bill, he notes, because Arden is hot in department stores and among high-spending shoppers at discounters such as Target, J.C. Penney, and Wal-Mart. He expects Arden will earn \$1.24 a share (above Arden's low-end guidance of \$1.20) in the year ending June 30, 2006, on sales of \$988 million, and \$1.43 in 2007 on \$1.1 billion. Goldman Sachs, with a 5.7% stake, and Morgan Stanley, with 4.1%, are among Arden's big investors.

NOT SO SWEET JUST NOW



Will a Small Operator Hang Up Its Phones?

WARWICK VALLEY TELEPHONE (WVY), a small operator in New York and New Jersey, has no Street following at all—one reason its stock has slumped from 25 in July to 17 now. Still, Joshua Eudowe of Santa Monica Partners, which owns shares, is upbeat. He figures it is worth 44 because of its 7.5% stake in the small but highly profitable Orange County Poughkeepsie Limited Partnership, 85%-owned by Verizon Communications. OCP, which sells wireless minutes to bigger companies, posted income of \$153 million on sales of \$180 million in 2005, with a net margin of 85%, notes Eudowe.

In 2005 it will produce income for Warwick of \$11.5 million, or \$2.16 a share. Warwick's OCP stake is worth \$163 million, or \$30 a share, figures Eudowe. Its phone business adds \$75 million, or \$14 a share. Eudowe is pushing Warwick to spin off its phones and operate as an investment firm with OCP as its main asset. CEO Herbert Gareiss declined comment. Without its phones, argues Eudowe, Warwick could be more profitable.

PRETTY SOGGY



PacificNet: A Yankee Player In China's Court

PACIFICNET (PACT) is an unusual China play. It is incorporated in the U.S. and trades on the NASDAQ—operates from China. It provides outsourcing and services such as call centers, telemarketing, customer relationship management, and e-commerce software. Clients include biggies like China Telecom, China Mobile, Bank of China, and the Hong Kong government. Stephen Leeb of Capital Management says the stock, now at 7.09, could do in a year because of PacificNet's rapid growth. Between Nov. 11 and Nov. 21 the stock plummeted from 8.35 to 6.34 as the company cut its earnings forecast for 2005. Tian Hou of C.E. Unterberg, Towbin, who rates the stock a buy, says PacificNet is back on track, having reversed a revenue drop in one of its units. Hou sees growth continuing in 2006. Earnings, she figures, jumped to 21¢ a share in 2005 on sales of \$42 million, up from 9¢ in 2004 on \$30 million. In 2006 she sees profits of 26¢ on \$50 million. PacificNet recently bought Hitching International, which sells financial advisory services in China through TV infomercials. Hou expects it will add 10¢ to earnings. It also bought Guangzhou Wanrong Information Technology, a telecom service provider. ■

NO SMASH LATELY



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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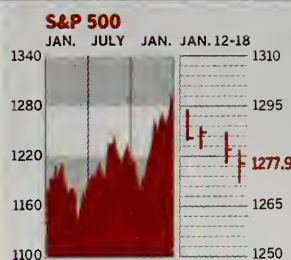
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Decide with Confidence

STOCKS



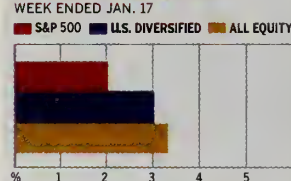
COMMENTARY

The week's higher oil prices and underwhelming tech profit reports scared the Dow off its 11,000 perch. Intel shares slid more than 11% after it reported disappointing revenues on lower sales of certain computer chips. Yahoo's less-than-perfect outlook sent its shares tumbling 16%. The spate of bad earnings news eclipsed a largely tame inflation reading.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	JAN. 18	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1277.9	-1.3	2.4	6.9
Dow Jones Industrials	10,854.9	-1.7	1.3	2.1
NASDAQ Composite	2279.6	-2.2	3.4	8.2
S&P MidCap 400	761.8	-1.4	3.2	17.9
S&P SmallCap 600	364.8	-1.0	4.0	14.6
DJ Wilshire 5000	12,835.9	-1.2	2.7	9.3

SECTORS

	JAN. 18	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	771.2	-1.0	4.0	9.7
BW Info Tech 100**	389.1	-3.7	2.3	7.1
S&P/BARRA Growth	611.4	-1.3	2.5	6.2
S&P/BARRA Value	662.1	-1.2	2.2	7.5
S&P Energy	406.0	1.2	8.9	39.2
S&P Financials	431.6	-1.9	1.2	6.3
S&P REIT	159.4	-2.0	4.2	16.1
S&P Transportation	247.7	-0.1	-0.8	11.3
S&P Utilities	165.5	2.0	3.6	17.2
GSTI Internet	206.0	-4.0	0.4	20.1
PSE Technology	872.3	-1.6	4.3	16.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	JAN. 18	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1551.3	-2.4	2.6
London (FT-SE 100)	5663.7	-1.2	0.8
Paris (CAC 40)	4772.1	-2.4	1.2
Frankfurt (DAX)	5395.6	-2.5	-0.2
Tokyo (NIKKEI 225)	15,341.2	-6.2	-5.0
Hong Kong (Hang Seng)	15,481.2	-1.1	4.1
Toronto (S&P/TSX Composite)	11,554.5	-0.6	2.5
Mexico City (IPC)	18,266.0	-4.7	2.6

FUNDAMENTALS

	JAN. 17	WEEK AGO
S&P 500 Dividend Yield	1.76%	1.75%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.7	18.8
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	15.0
First Call Earnings Surprise*	3.88%	9.13%

TECHNICAL INDICATORS

	JAN. 17	WEEK AGO
S&P 500 200-day average	1215.9	1214.3
Stocks above 200-day average	66.0%	69.0%
Options: Put/call ratio	0.61*	0.59
Insiders: Vickers NYSE Sell/buy ratio	3.96	3.92

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Gold Mining	13.8	Oil & Gas Refining	9.76
Oil & Gas Refining	12.4	Oil & Gas Exploration	72.7
Agricultural Products	11.7	Oil & Gas Equipment	66.1
Oil & Gas Equipment	9.5	Oil & Gas Drilling	63.0
Oil & Gas Drilling	9.1	Constr. & Engineering	55.9

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Internet Software	-16.5	Automobiles	
Educational Services	-14.0	IT Consulting	
Home Furnishings Retail	-11.6	Photographic Products	
Hypermkts. & Suprcntrs.	-6.4	Auto Parts & Equip.	
Health-Care Supplies	-5.8	Internet Retailers	

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN		52-WEEK TOTAL RETURN	
	%		%
LEADERS			
Precious Metals	18.3	Latin America	72.9
Latin America	9.9	Natural Resources	54.0
Diversified Emerg. Mkts.	8.7	Precious Metals	52.1
Natural Resources	8.1	Diversified Emerg. Mkts.	45.4
LAGGARDS			
Miscellaneous	1.5	Domestic Hybrid	7.8
Financial	1.8	Miscellaneous	8.4
Domestic Hybrid	1.9	Large-cap Blend	9.6
Large-cap Value	2.1	Large-cap Value	10.3

EQUITY FUNDS

4-WEEK TOTAL RETURN		52-WEEK TOTAL RETURN	
	%		%
LEADERS			
ProFunds Precs. Mtis. Inv.	27.6	ING Russia A	95.0
U.S. Global Invs. Gold	26.9	ProFunds Ultra Japan Inv.	83.8
U.S. Gl. Invs. Prec. Mnlis.	25.1	iShares MSCI Brazil Idx.	82.9
Amer. Cent. Gl. Gold Inv.	21.4	Guinness Atkn. Gl. Energy	81.3
LAGGARDS			
Guardian UBS Sm. Cap Val. A	-10.0	American Heritage Grth.	-42.9
Rydex Dyn. Vent. 100 H	-9.5	ProFds. USh. Mid Cap Inv.	-28.3
Potomac Sm. Cap/Sh. Inv.	-8.5	ProFds. USh. Sm. Cap Inv.	-23.2
ProFds. USh. Sm. Cap Inv.	-8.5	Potomac Sm. Cap/Sh. Inv.	-22.1

INTEREST RATES

KEY RATES

	JAN. 18	WEEK AGO
Money Market Funds	3.85%	3.83%
90-Day Treasury Bills	4.35	4.30
2-Year Treasury Notes	4.33	4.42
10-Year Treasury Notes	4.33	4.45
30-Year Treasury Bonds	4.51	4.63
30-Year Fixed Mortgage †	5.96	6.06

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BONO	30-YR.
General Obligations	3.76%	
Taxable Equivalent	5.37	
Insured Revenue Bonds	3.87	
Taxable Equivalent	5.53	

THE WEEK AHEAD

LEADING INDICATORS Monday, Jan. 23, 10 a.m. EST » The Conference Board's monthly index of leading economic indicators is forecast to have edged up 0.1% for December. That's according to the median forecast of economists surveyed by Action Economics. In November the index rose 0.5%.

EXISTING HOME SALES Wednesday, Jan. 25, 10 a.m., EST » Home sales probably held steady in December

at an annual rate of 6.97 million, after easing slightly in November.

DURABLE GOODS ORDERS Thursday, Jan. 26, 8:30 a.m. EST » December durable goods orders most likely grew at a tamer pace of 0.8%. November orders surged 4.4% because of a spike in civilian aircraft orders.

GROSS DOMESTIC PRODUCT Friday, Jan. 27, 8:30 a.m., EST » Real gross domestic product is expected to have grown

at an annualized rate of 2.8% for the fourth quarter. The economy grew at an annualized rate of 4.1% in the third quarter. Softer consumer spending and wider trade deficits should account for most of the slowdown.

NEW HOME SALES Friday, Jan. 27, 10 a.m. EST » December new home sales probably remained virtually unchanged at an annual rate of 1.24 million, from 1.25 in November.

The BusinessWeek production index moved up to 271.1 for the week of Jan. 7, and stood 13.2% above year-ago level. Before calculating the four-week moving average, the index retreated to 268.9.

BusinessWeek on

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/

Environmental Solutions: 2006

Progressive Ideas and
Leading Technologies



Liability Transfer Relieves Burden of Idled Facilities

Decision to discontinue operations brings the challenge of managing idled facilities. These properties pose environmental compliance challenges, including statutory and financial liabilities, and caretaker expenses." In the wake of recent changes to accounting standards (FAS 143, as amended by FIN 47), deferring the environmental liabilities of idled facilities is no longer an option. Innovative environmental compliance programs help companies avoid the burden of idled facilities and unlock the long-term value of the real estate option, known as liability transfer, helps owners manage liability more efficiently, and speeds the redevelopment of the land.

Liability transfer programs typically offer one or all of the following:

- Guaranteed cost certainty for a fixed period of time by using environmental insurance to back the compliance activities
- Long-term protection from costs associated with changes in regulatory requirements
- Financial backing by a parent company's indemnification and insurance

Liability transfer has been exceptionally valuable for the manufacturing industry. For example, a successful liability transfer expedited the redevelopment of a former industrial property after an electronics manufacturing facility ceased operations. Environmental

investigations discovered extensive soil and groundwater contamination that complicated redevelopment efforts. For a fixed cost, the company transferred its liability to a third party. This solution made it possible for the company to garner approval for the redevelopment from local municipal authorities and implement a more cost-effective and environmentally protective solution that met state regulations. Ultimately, the company was able to sell the land and recoup its latent real estate value.

As the above example demonstrates, companies do not have to shoulder the burden of idled facilities. By transferring liability for a contaminated site to a responsible third party, they can reduce corporate costs and expedite land restoration.



TRC
Focused Solutions

TRC pioneered liability transfer with the TRC Exit Strategy® program, which offers a unique solution to relieve environmental liabilities—forever. With Exit Strategy, you are guaranteed absolute cost certainty, total liability relief, and long-term financial assurance. TRC has accepted perpetual liability for approximately 90 properties throughout the United States. These Exit Strategy projects are backed by over \$1 billion worth of state-of-the-art environmental insurance. www.trcexitstrategy.com • 949.727.9336

Reduce the Cost and Time Required for Contaminated Property Cleanup

Use of proven, advanced, controlled-release products can yield cost savings of 30 to 50% compared to traditional methods applied to groundwater and soil for the restoration of contaminated properties. Environmental engineering firms which put their customer's interests first have used such products on tens of thousands of contaminated sites to cost-effectively degrade a wide range of common commercial and industrial pollutants. These products have demonstrated performance cost savings on properties owned by 100 companies small to medium sized businesses, state and local governments. When a property owner faces environmental remediation including subsurface soil and groundwater

contamination, the owner typically retains an environmental consulting/engineering firm to develop and implement a solution. Too often, however, environmental firms may recommend a solution, such as mechanical pumping and treating, which is inefficient, or the costly and labor intensive injection of quickly spent, commodity-type chemicals into the subsurface. The property owner, in return, can incur significant and unnecessary costs in the form of long-term, monthly payments to the engineering firm for system maintenance and/or multiple injections of low value, commodity chemicals.

Progressive engineering firms are saving their clients money and time by proposing the use of

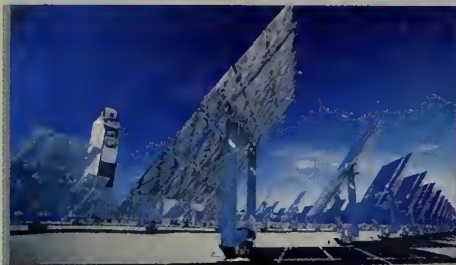
advanced, patented technologies in the form of controlled-release chemical products that are applied directly to the polluted subsurface. Once in place these products continue to operate for extended periods of time, ensuring contaminant destruction...without the costly, routine injection of low value chemicals and without the labor intensive maintenance required of other mechanical remediation systems. Quarterly sampling of groundwater or soil is all that is required while the remediation continues....dramatically reducing cleanup costs to the property owner. Often, advanced controlled-release products are used to degrade subsurface pollution while time sensitive site improvements continue aboveground, allowing for redevelopment and building occupation to proceed as if no site remediation activities were underway at all.


REGENESIS

Regenesis is the global leader in developing innovative technologies to reduce the cost and time required for the restoration of contaminated properties. Established in 1994, Regenesis revolutionized the property restoration industry with the development of ORC® to treat petroleum contaminants, HRC® to treat solvent contaminants and now RegenOx, a new technology to rapidly treat a broad range of contaminants on-site. Application design and support services are available to engineering firms world-wide at no charge. www.regenesis.com

Environmental Solutions 2006

Progressive Ideas and Leading Technologies



Operational Risk and Compliance Management Drives Sustainable Value

21st century industrial enterprises are under increasing pressure to cut costs to stay competitive. Today, corporate leaders are facing new scrutiny from not only regulatory agencies but financial institutions and investors to reduce operational risks. Proactive manufacturers are now focused on driving Environmental, Health and Safety best practices to sustain cash flows and increase shareholder value. The new reality is that leaders can no longer ignore these risks, because poor performance means lower public, insurance and credit ratings, impacting a corporation's access to capital.

Existing regulations and emerging laws governing risk management, including Basel II, are setting the

stage for manufacturers to replace costly and ineffective processes for controlling frontline risks. Until now, manufacturers have not focused on operational risk and compliance management as a priority. Worse, corporate leadership has not had visibility into the risks they face each day at the plant level—minor incidents go unnoticed, stacking up, poised to erupt into expensive disasters that impact employee safety, resulting in large fines and public relations nightmares.

As an executive in charge, how confident are you regarding your corporate risk position? Do you know what really occurs on the frontlines? Are you fully aware of your legal risk and compliance liabilities? If you've had a major incident occur, what has that done

to your shareholder confidence and value?

Corporations need a more proactive, systematic and compliance management plan to anticipate frontline issues in real time, instead of reacting late to historical statistics and analysis. Corporate leaders need to know their internal operational risk rating at all times. Proactive corporations are already taking the initiative by implementing enterprise class software solutions to give their corporation a 21st century view of their operational risks. These companies are less likely to be subject to drastic regulatory action because they can track a record of preventative measures. The result is improved profitability and cash flows, higher shareholder confidence and sustained shareholder confidence.



Perillon is the leading provider of enterprise operational risk and compliance management software enabling global industrial corporations to enhance corporate oversight of frontline manufacturing operations. Through Perillon's technology leaders, these companies proactively manage their operations, including environmental, health and safety, streamlining processes, reduce risks and cut compliance costs. Perillon's RCM Series products are offered as either an ASP subscription-based Enterprise license deployment. Microsoft® Certified Partner. www.perillon.com • info@perillon.com • 978.486.3016

Future Solutions to an Earth-Friendly Environment

The increasing demand for technological innovation paired with the growing trend for fashionable gadgets and electronics is fostering new environmental regulations and increased worldwide concern for the entire ecosystem. There are also regional discrepancies in the severity of environmental regulations imposed and industry reaction to these regulations. In Europe for example, public reaction to enforcing new regulations (such as REACH, RoHS, & WEEE) is hindered by the disagreement between government and the public as to exactly what these guidelines will declare. Considering all the regulations imposed or awaiting approval across the globe, "regulation overload" becomes apparent.

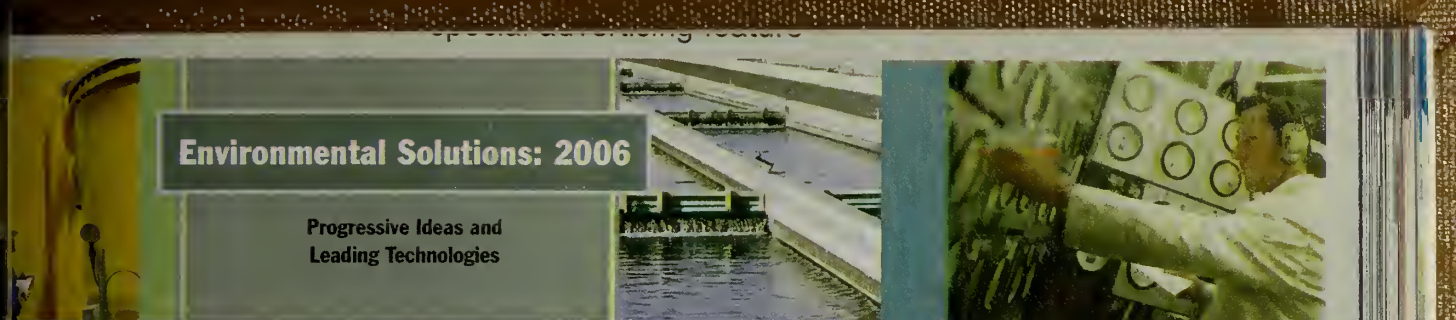
Smaller firms will suffer more from the higher costs required for compliance. But large corporations could suffer as well. Due to the high recognition, reputation, and respect of the brands owned by large corporations, one mistake in implementing the required regulations or publicly rejecting the "reasonable steps" asked of your company can tarnish your brand forever. The trust, loyalty, and expectations of the customer center around a corporation's ability to leverage their brand against all odds in favor of its target market.

More and more corporations are relying on the expertise of outside consulting companies to help them sort through the "confusion of compliance". A sound consulting company must be a "one-stop-

shop" providing vendor training, global lab coverage for materials and components certification, environmental and quality compliance audits, 24/7 library of materials, components and compliance data. In addition, the consulting firm must provide the 3 Cs to compliance—cost by offering pre-screening alternatives in the supply level assessment of homogenized parts, current information on all regulations proposed globally, and confidential relationship between client and consultant. Intertek, a global leader in testing, certification, and risk management, works with advisors and local experts to develop innovative solutions for renowned corporations across the globe. For example, Intertek supports Microsoft in developing a successful business approach that defines their relationships with complete clarity to suppliers and alike through educational programs, effective testing systems, and continuous improvement.

Intertek

To learn more about Intertek and their services, please contact a representative directly at environment@intertek.com or visit website at www.intertek.com. Intertek is comprised of five divisions, nearly 13,000 employees, and operates in more than 830 laboratories across the globe. Global leaders place their trust in Intertek to accurately assess products & commodities to safety and quality standards, and quality & performance criteria set by Standards Development Organizations, industries, and customers every



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n Air Ruling Mandates Wastewater tment Innovations For Industry

Environmental Protection Agency's recently Clean Air Interstate Ruling is aimed at drastically reducing emissions of sulfur dioxide and mercury from U.S. power plants. Additionally, the ruling has accelerated the advancement of wastewater treatment systems customized to treat organic and inorganic pollutants in the wastewater stream purged from the pollution control equipment.

Consequently, many wastewater treatment systems must now consist of three distinct systems; 1) a physical-chemical system, which removes inorganic contaminants by chemical precipitation and pH adjustment to render them

insoluble, 2) a biological treatment system, which removes nitrogen compounds, organics and soluble heavy metals that pass through a physical-chemical system, and 3) a sludge handling system, which dewater the combined solids captured from the upstream sub-systems.

While general wastewater clarification techniques have been used for many years, by far the most intriguing component of this trio of sub-systems is the biological treatment process. Key to this robust design is the use of a staged reactor to support the growth of distinct groups of bacteria within the naturally occurring population. Automated controls ensure the sequential

elimination of pollutants and maintenance of conditions that support optimized treatment performance in subsequent reactor stages. Of particular interest is the use of sulfate-reducing bacteria, previously associated with causing corrosion, now controlled to achieve beneficial environmental results via the reduction and precipitation of heavy metal contaminants that have historically proven difficult to remove with conventional treatment.

This design approach provides operational flexibility that can be adapted to almost any type of effluent treatment problem spanning multi-industries. Furthermore, such integrated systems are also substantially less costly and easier to maintain than previously used techniques such as ion exchange or zero-liquid discharge and offer industry a cost-competitive compliance solution to increasingly stringent effluent requirements.

Infilco Degremont
SVEZ

INFILCO DEGREMONT, INC. offers more than a century of experience in providing innovative water and wastewater treatment equipment and technology solutions for thousands of the most difficult industrial and municipal system applications. Backed by our fully staffed research and development center in Richmond, VA, application of leading-edge technologies, such as our DensaDeg™ high-rate clarifier/thickeners or our multi-staged biological treatment systems are routinely engineered to meet exacting customer requirements. 804-756-7600 • www.InfilcoDegremont.com

Plasma Converters Destroy Wastes and Save Electricity, Hydrogen and Money

After twenty years in development, Plasma Converters are now on the market using the power of plasma to destroy wastes, no matter how hazardous, lethal, and from them make commodities of electricity, hydrogen and methanol for sale at low raw costs.

Plasma Converters are in use throughout the world in North America, South America, Europe, Africa, Asia and Australia. Most installations are processing a combination of hazardous waste and municipal solid waste. Most will generate electricity from the PCG syn-gas while producing methanol and hydrogen. The recent rise in natural gas prices has driven up

the value of the PCG produced from wastes.

Two thousand tons-per-day of household garbage produces enough hydrogen to power 100,000 fuel cell cars every day.

"Two thousand tons-per-day of household garbage produces enough hydrogen to power 100,000 fuel cell cars every day."

In many countries, incinerators and waste dumps are being closed and outlawed. And this is also driving the market for Converters.

The System uses closed-loop elemental recycling to safely and irreversibly destroy municipal solid waste, organics and inorganics, solids, liquids and gases, hazardous and non-hazardous waste, industrial by-products and also items such as "e-waste," medical waste, chemical industry waste and other specialty wastes and converts many of them into useful commodity products that can include metals, a synthesis-gas energy product called Plasma Converter Gas (PCG)™, and also hydrogen for use and for sale.

The Plasma Converter System safely and economically destroys wastes, far safer than environmental standards, and helps protect the public health and safety.

A waste industry and energy company states that all wastes are valuable renewable resources. Plasma Converters process, as feedstocks, materials previously regarded as wastes.

STARTECH
ENVIRONMENTAL CORP.

A Waste Industry and Energy company selling its new plasma processing equipment known as the Plasma Converter System™. Plasma Converters safely and economically destroy wastes, no matter how hazardous or lethal, and turn them into useful and valuable products. 203-762-2499 or sales@startech.net.

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Progressive Ideas and Leading Technologies



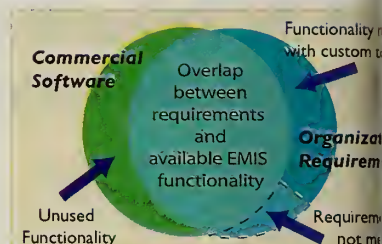
Strategic Selection of an EMIS Software Solution

Sarbanes-Oxley requirements have increased interest in EMIS (EH&S Management Information System) technologies. Simultaneously, EMIS tools have matured and software product choices are plentiful. EMIS products are not "one size fits all" and many off-the-shelf products require at least some configuration or customization. Furthermore, each organization has multiple and unique requirements, some of which may not be fulfilled with off-the-shelf products. The best solution may combine commercially available software products and custom applications.

A system requirements analysis should be performed before EMIS software product selection. The analysis should focus on user workflow and work

roles, user/stakeholder requirements, data input and output, legacy system displacement, and the organization's IT standards. Once completed, a prioritized list of requirements with input from future users can be useful to evaluate EMIS software products. Typical concerns that influence selection include:

- Systems integration and interfaces – Will the EMIS system need to integrate with current legacy systems (process historians, ERPs, etc.) or engineering, regulatory, and scientific software packages?
- User interface – In what ways should the user interface be tailored for specific workflows or sites?
- Data input/import tools – What tools are available to simplify input of electronic data?



- Reporting – What are the regulatory and management reporting needs?

- User notifications – What task tracking, change activity, and event notifications are needed?
- Other standard system considerations include comprehensiveness, functionality, usability, maintainability, and adherence to technology standards. Proper analysis increases the overlap between commercial software and organizational requirements for a successful implementation.



T3® has unparalleled expertise in the implementation and integration of sustainable EMIS solutions. Clients benefit from our strategic ability to craft solutions based on their identified needs, our project management ability to keep the project on track and within budget, and our technical capability to deliver the solution as promised. For more information on successful EMIS selection and implementation request T3's free *Manager's Guide to EH&S Management Information Systems* at www.tthree.com/EMISguide or 972-661-8121.

Pollution Liability Affecting Corporate Bottom Line Exposures

Property owners and developers – through operations, owned premises and contractual obligations – face a number of environmental exposures that can devastate a profitable business. Pollution liabilities result from the existing or unknown contamination of historical usage, neighboring commercial properties or poor building practices, and come in a variety of shapes and forms. Past and present-day poor house-keeping and waste management practices, leaking underground storage tanks, sick building syndrome and accidental spillage of pesticides, paints, solvents, flammable solvents, fertilizers and other products can all result in unforeseen environmental litigation. Current federal law permits recovery of costs from

any party ever associated with a contaminated property, even those who acquire it after the contaminating activities cease, which puts property owners at high risk. Pollution events result in the loss of property value and future business worth and can cost property owners millions of dollars.

Adding insult to injury, claims against property owners for claims resulting from pollution conditions are not covered under standard insurance policies. Broad policy language excludes coverage for any insurance claims that result from pollution exposures. Dry cleaner solvent contamination? Not covered. Leaking fuel oil storage tank? Coverage denied. Tenant sues property owner due to mold exposure? Claim denied.

Environmental liability is one of the most common issues facing mergers, acquisitions and transactions. Known and unknown pollution from industrial operations creates uncertainty and can have a significant negative affect on the new corporate balance sheet. Even with a high degree of certainty that exposures are adequately quantified, existing, unknown contamination can arise and negatively impact earnings. Environmental insurance is frequently utilized as an effective mitigation tool, removing uncertainty with a financially sound solution and protecting property buyers and sellers from long-term environmental liability.

It is a reality that if you own or have owned property in the United States you have an environmental exposure. Property owners are taking a proactive approach to this risk via insurance products, which are now more readily available than ever.



Hilb Rogal & Hobbs (HRH) is the eighth largest insurance brokerage firm in the United States, with over 125 offices throughout the country. HRH helps clients manage their risks in property and casualty, employee benefits, professional liability, and other areas of specialization. They make it their business to understand clients' businesses, employees and risks, as well as the insurance and financial markets that they can find them the carriers and coverages that best fit their needs. Phone: (804) 747-6500 • www.hrh.com

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Helping Protect China's Daya Bay

The new Nanhai Petrochemicals complex in the Economic and Technical Development Zone on the southern coast can produce 2.3 million plastics and chemicals annually for China's burgeoning economy. One of the world's largest petrochemical plants, it spans 1.65 square miles. A \$4.3 billion project of the government-owned China National Oil Corp. and Shell Petrochemicals Co. Ltd., the largest joint venture in China's history. The facility required a massive, \$45 million wastewater treatment system to handle 3,500 liters of raw water going in and 550 cubic meters of wastewater coming out per hour. Water must be highly purified to feed the plant's

steam boilers. Industrial wastewater coming out, as well as the plant's rainfall runoff, must be carefully treated to ensure environmental stability of Daya Bay's deep-water harbor and local community.

Engineering such a system demanded:

- a single firm responsible for managing design, construction and commissioning;
- preliminary risk and safety studies to ensure an intrinsically safe outcome; and,
- a focus on long-term health, safety, environmental management and sustainability, using technologies such as membranes and bioreactors, 3-D CAD design and seamless project management information systems.

An internationally recognized engineering consulting firm worked with a government-owned Chinese design institute and with Chinese construction and onshore materials subcontractors, while handling bidding and importing of major system equipment. The



resulting system includes raw water treatment, ultra-filtration and demineralization as well as a controlled discharge basin and effluent pump station and treatment plant. This high-quality water/wastewater system meets the joint venture's expectations for reliability, safety and environmental standards. Built on internationally recognized principles of sustainable development, it helps meet the Daya Bay region's economic needs while helping protect its natural resources and people.



MWH Global, Inc. is a private, employee-owned firm with approximately 6,000 employees worldwide. The company provides water, wastewater, energy, natural resource, program management, consulting and construction services to industrial, municipal and government clients in the Americas, Europe, Middle East, India, Asia and the Pacific Rim. (303) 533-1900 • www.mwhglobal.com

What is an Environmental Management System?

An Environmental Management System (EMS) is a management system that addresses the environmental impact of a company's processes, products and services on the environment. The EMS provides a structured framework for ensuring that environmental issues are considered, and works to both control a company's significant environmental impacts and ensure regulatory compliance. ISO 14001 is an internationally recognized Management System standard. Should a company consider ISO 14001 certification?

The primary value of an ISO 14001 compliant system is to identify environmental aspects and control potential environmental impacts that result

from a company's processes, products or services. This will facilitate reducing the likelihood of an environmental impact occurring and can also reduce the magnitude or severity of the impact. It can also improve processes and increase the productivity and effectiveness of the system. These attributes can in turn result in reduced scrap and rework, more efficient handling and disposal of waste and by-products and therefore increased profitability. This has the potential to increase customer satisfaction and raise stakeholder confidence in the company.

2) From a sales and marketing point of view, would certification make a difference? With a like price, product or service to your competitors,

would ISO 14001 certification make a difference in your customers' decision process in selecting a supplier? Does certification represent a means of differentiating you from your competition? Are you losing business because your competitors are already certified?

3) Are one or more of your largest customers likely to require that you have ISO 14001 certification in order to continue to be a preferred supplier, or worse, require certification to even be allowed to bid on contracts?

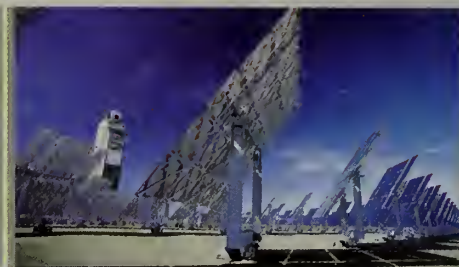
4) Are there regulatory requirements or incentives for you to have ISO 14001 certification? ISO 14001 certification does not relieve you of the obligation to comply with federal, state and local environmental requirements.

More than 5000 companies in North America have chosen to pursue ISO 14001 registration — should yours?

DNV Certification is one of the world's leading certification bodies for ISO 14001, ISO 9001 and other management system standards. www.dnvcert.com/businessweek Tel: 1-877-368-3530. DNV Training is one of the world's leaders in management systems training, assessments and implementation. www.dnvtraining.com/businessweek Tel: 1-888-216-0284. DNV is an international organization with a network of 300 offices spread over all the continents in 100 countries. DNV's 6,400 employees work at key locations in Europe, in the Americas and in Asia and Australia.

Environmental Solutions 2006

Progressive Ideas and Leading Technologies



The Rising Cost of Heating; Why Solar is Now the Most Viable Solution

The increasing cost of conventional energy creates uncertainty for businesses, making short and long term forecasting difficult for this major input. The traditional wisdom is that new technology can best remedy the problems of today, and this is a notion that holds especially true in the energy sector. An example of this is solar air heating, which efficiently and cost-effectively converts the free energy of the sun into usable heat for buildings.

Modern solar air heating panels are all-metal and completely building integrated, which contributes to their cost-effectiveness. The concept is simple. The metal cladding used as the solar collector consists of thousands of tiny perforations and is mounted on a

south facing wall where the sun exposure is the greatest. The panels, referred to as a transpired solar collector, capture the heat that naturally collects on darker surfaces. The perforations allow the warmed air to be drawn into the building's heating system where it is distributed through conventional methods.

Incorporating solar air heating technology into the building can prove to be an immediate cost saver. Firstly, there are the direct and



ongoing energy savings. Secondly, to keep costs manageable there are many financial incentives offered by different state governments and at a federal level, the United States and Canada Governments offer a 30% tax credit and a 25% respectively. This means that constructing a transpired building may actually represent the more expensive option. With these financial incentives, "going solar" can yield the lowest capital and operating costs, both the short and long term.

To build a wall that only provides a barrier between the inside and outside environment can be logically outdated. For similar or even lower cost than traditional building materials, a transpired collector provides space heating, CO2 reduction and ventilation air for the building. It is technology like this that enables businesses to have a sustainable heating solution that minimizes energy costs while projecting a green corporate image.

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This system has been used globally for the past 20 years, and has garnered numerous awards. Customers include Wal-Mart, Ford, GM, Bombardier, the U.S. Military, and NASA. The technology is available from Conservall Engineering Inc. (Trademark SOLARWALL®) of Buffalo, NY and Toronto, Canada, (W: www.solarwall.com, E: info@solarwall.com, T: 416-661-7057); and from InSpire International Inc. (Trademark InSpire Wall) of Allentown, PA, (W: www.atas.com, E: info@atas.com, T: 610-395-8445)

Stop Outsourcing Profits. Strong Relationships Build Bottom Lines

Environmental costs continue to soar resulting in budget cuts and down-sized Environmental Departments. Many companies leave Environmental Managers with no staff, resulting in inadequate time to perform tasks. To fill gaps, companies hire Consulting and Engineering Firms to perform oversight and management. These companies outsource to providers for each facet of service to save money for their client. Instead partner with a full service environmental company which will provide greater savings and superior service.

Outsourcing environmental service oversight and then outsourcing individual services doesn't save money. Higher prices result from consultants billing "cost plus," meaning for each subcontractor utilized, an

overhead and profit fee, typically adding 25% to fees you could pay directly. There are also longer lead times waiting for and evaluating numerous quotes, and choosing service providers. A partnership with one company eliminates these markups and improves the bottom line, while meeting a Company's needs with more personalized service.

An efficient solution satisfying the budget and time conscious business, is establishing a partnership with one company performing the majority of your environmental services. Many Environmental Services Companies that profess full service are not. You need to know what to ask. First determine your environmental service needs, then group like services, and lastly

quantify costs and volumes. Armed with actual data you can locate two or three full service environmental companies that provide these services. Before you interview, as if you were hiring for employment. Determine what additional services can be provided as "value added services" such as port and disposal of waste, can they do manifesting, compliance reporting and manifesting. Once you decide on a Company, outline expectations, reporting guidelines, time frames and the timeline. Communication is vital to making an environmental partnership work. Rather than using consulting or environmental engineering firm sources, utilize a full service environmental company. Keep your engineering relationship for just engineering.

Creating a partnership with an environmental services provider and cultivating that relationship will provide benefits resulting in a better bottom line.

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Danger: Falling Prices

THE WAL-MART EFFECT How the World's Most Powerful Company Really Works—and How It's Transforming the American Economy
By Charles Fishman; Penguin Press; 294pp; \$25.95

Fifteen years ago, supermarkets were the place to go for groceries. Today, there's another option: Wal-Mart Stores Inc. The reason people go there isn't better product selection or more convenient locations. It's price. A family of four might cut its \$500-a-month food bill by \$75 by shopping at Wal-Mart, equal to

about seven weeks of groceries a year. A big win for society, right? Not everybody thinks so. In the past decade and a half, 31 grocery chains have gone bankrupt, with 27 of them pointing to Wal-Mart as a cause.

It is, writes author Charles Fishman, a quintessential example of the Wal-Mart effect: neither 100% good nor 100% bad, yet profoundly far-reaching. And it's all due to the retailer's unflagging determination to cut prices. The single-mindedness explains how Sam Walton and his skinflint successors turned a small thrift store in rural Arkansas into the world's biggest company outside of today's booming oil sector, with sales approaching \$1 billion a day. The behavior also leads Fishman to conclude that Wal-Mart has probably hit its peak, a theory he spells out in the well-written and insightful *The Wal-Mart Effect: How the World's Most Powerful Company Really Works—and How It's Transforming the American Economy*.

From the company's opening day in 1962, Fishman recounts, management has been ruthless in pinching pennies. Its excesses, he says, range from paying miserly wages to strong-arming U.S. suppliers to outsource their work to Third World sweatshops. Fishman reports that Wal-Mart even furnishes offices in its Bentonville (Ark.) headquarters with mismatched chairs handed out by suppliers as samples. From the get-go, however, Wal-Mart also has made sure to cut its shoppers in on the bargain. Take groceries: Wal-Mart's supercenters sell fresh salmon from Chile for just \$4.84 a pound, year round. No wonder their parking lots are full.

Wal-Mart's price mania is almost beguiling—except that it has grown into a hulk whose bullying makes even such giants as Procter & Gamble Co. and FedEx Corp. fearful. Wal-Mart is so dominant, in fact, that it sells more each year by St. Patrick's Day, in mid-March, than Target Corp., its nearest rival, sells all year. Meanwhile, the ranks of those who feel abused by Wal-Mart—vendors, employees, politicians, and, increasingly, shoppers tired of poorly stocked stores and shoddy goods—are growing even faster than the company, Fishman writes.

Wal-Mart can't reduce prices indefinitely, says the author. After decades, it has achieved the most obvious cost cuts. Store managers, for instance, already stand accused of forcing employees to work off the clock to save money. And so many suppliers have decamped to low-wage China that Wal-Mart now accounts for almost 10% of imports from that country. What happens when Wal-Mart insists that vendors or employees take another nickel cut, and they just can't? "The source of Wal-Mart's troubles can be traced not to some evil conspiracy spun out of the home office," Fishman argues, "but to the slogan printed right on every Wal-Mart bag: 'Always low prices. Always.'"

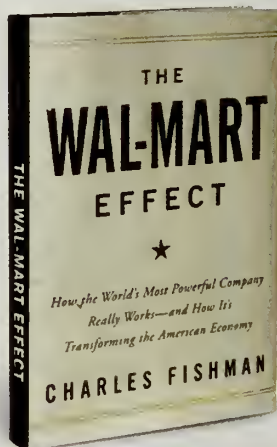
Fishman, a senior editor at *Fast Company*, has done his research. He relates inside stories from retired Wal-Mart executives and suppliers. He gives space to an academic paper that proves Wal-Mart lowers retail prices when it moves into new markets, and another that proves it kills jobs, too. He takes you up and down the aisles of Wal-Mart's big boxes, alternately marveling at the pallets of cheap lightbulbs and griping about the long waits at the checkout counter. He makes facts and figures easy to grasp—and puts it all together in a breezy style. Although the folks in Bentonville won't like it, *The Wal-Mart Effect* is not an anti-Wal-Mart screed.

But there is something missing: Those folks in Bentonville. Although Fishman has written about Wal-Mart before, there is no evidence in his book that he has ever set foot in its headquarters or even driven around the town. He gives Wal-Mart's side of most stories, but the quotes all come from other sources such as newspaper clips or court filings. At a minimum, management deserved the right of rebuttal. And if Fishman gave executives the chance and they said no, well then he should tell us so.

Wal-Mart has taught Americans to worship bargains above all else

Nonetheless, Fishman succeeds in showing how the company works and how it is transforming the economy. Over 40 years, Wal-Mart has taught Americans to love a bargain above anything else. Fishman says it even deserves praise. "No company can claim greater fidelity to its core value," he writes. "No company, in that sense, is more trustworthy than Wal-Mart." But even titans fall if they can't adapt. Inevitably, Fishman predicts, a day will come when another rival prices its products lower than Wal-Mart. And that day is closer than its managers probably think.

—By Michael

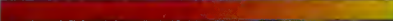


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Ideas The Welch Way

BY JACK AND SUZY WELCH

The Leadership Mindset

I've been appointed to a senior leadership position for the first time. It's a challenging job, and I want your advice on how to approach my new role.

—Darlington Ntuli, Randburg, South Africa

First of all, kudos are in order. Not for getting promoted, though that's great. But kudos because you seem to understand that being a leader means you will actually have to change how you act. Too often, people who are promoted to their first leadership position miss that point. And that failure probably trips up careers more than any other reason.

Being a leader changes everything. Before you are a leader, success is all about you. It's about your performance. Your contributions. It's about raising your hand, getting called on, and delivering the right answer.

When you become a leader, success is all about growing others. It's about making the people who work for you smarter, bigger, and bolder. Nothing you do anymore as an individual matters except how you nurture and support your team and help its members increase their self-confidence. Yes, you will get your share of attention from up above—but only inasmuch as your team wins. Put another way: Your success as a leader will come not from what you do but from the reflected glory of your team.

Now, that's a big transition—and no question, it's hard. Being a leader basically requires a whole new mindset.

You're no longer constantly thinking "How can I stand out?" but "How can I help my people do their jobs better?" Sometimes that requires undoing a couple of decades of momentum. After all, you probably spent your entire life, starting in grade school and continuing through your last job, as a contributor who excels at "raising your hand." But the good news is that you've been promoted because someone above you believes you have the stuff to make the leap from star player to successful coach.

What does that leap actually involve? First and foremost, you need to actively mentor your people. Exude positive energy about life and the work that you are doing together, show optimism about the future, and care. Care passionately about each person's progress. Give your people feedback—not just at yearend and midyear performance reviews but after meetings, presentations, or visits to clients. Make every

significant event a teaching moment. Discuss what you'll learn about what they are doing and ways that they can improve. Your energy will energize those around you.

And there's no need for sugarcoating. Use total candor, which happens, incidentally, to be one of the defining characteristics of effective leaders.

Through it all, never forget—you're a leader now. It's not about you anymore. It's about them.

I've always heard it said that "there is no profit in winning if you lose your soul." Will historians say of us: "They won the new global economy...but destroyed families, communities, and even nations"? What do you call winning?

—Doug Flett, Edinburgh, Scotland

Winning, actually, doesn't have anything to do with the markets or profits—though it can. Winning is a personal journey. It's about reaching a destination you choose. At its most fundamental, winning is about achievement. Your purpose could be creating a happy family, teaching children to read, sailing around the world. Then again, it could be building a company that succeeds in the global marketplace.

Your suggestion that economic success is somehow, by definition, morally corrupt is dead wrong. Look, winning business is not a zero-sum game. In sports, when one team wins, the other loses. In business, when a company wins, there are usually collateral winners, too. The executives and shareholders, of course, but also employees, distributors and suppliers. Success often leads to dozens of startups that supply the "mother" company, creating jobs, the lifeblood of any society. When people have meaningful work, they have the freedom to set goals, not just survive. They have the freedom to dream.

Sure, there are those who lose their souls to profit. The story gets refreshed with every new account of corporate cheating. There always will be corrupt jerks in every field, from the priesthood to politics. But we believe that most businesspeople want to win the right way. They want to build companies or help build them. They want to search for new ideas. They want to invent new technologies. They want to live better life for their families, friends, and colleagues.

Will future historians look back on these people and say their definition of winning ruined the world? Or might they just say they made it a better place? ■

*Jack and Suzy Welch are co-authors of the best-seller *Winning* (HarperCollins 2005). They look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com.*



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Learning to Live With Offshoring

FEW MANAGEMENT trends have been as defining—or as divisive—for the American economy over the past two decades as the practice of companies moving employment or business functions to other nations that can do the work cheaper or better (page 50). Call it outsourcing or offshoring, but one effect is the same: job loss at home.

Whether outsourcing will prove to be a long-term benefit or hindrance to the U.S. economy is debatable. But the point increasingly seems moot. Offshoring is so widespread today that almost any company of size is doing it or preparing to. Indeed, outsourcing of manufacturing to China has become almost standard practice, and it is a prime cause of last year's near-\$200 billion trade deficit with the mainland. Gartner Inc. estimates the value of offshore information technology and business-process outsourcing totaled \$34 billion in 2005 and could double by 2007. India's 60% share of that business will likely decline due to growing wages there. But countries like Russia, Egypt, and South Africa are ready to step in and could account for \$30 billion in outsourced services work in two years.

Competition will only grow fiercer as more countries recognize that, unlike capital-intensive manufacturing

Policymakers must address the challenge to the security of the U.S. workforce

shoulder expensive employee benefits, such as health care or pensions, on their own. For instance, governments of some countries, including Japan, handle most health costs, while developing nations such as China don't even offer certain benefits considered de rigueur in the U.S. and Western Europe. That calls into question the structure of America's safety net, which for the past half-century has effectively been shared by employers and government. Policymakers must focus their attention on this threat to our competitiveness.

But recognizing that the world has changed inexorably need not spark a cost-driven global race toward the bottom for worker pay and benefits. Many successful German manufacturers have shown that a highly trained workforce can still command top wages in today's global marketplace.

operations, service outsourcing is relatively cheap to set up and generates up to 100 times as many jobs per dollar invested. That presents a huge challenge to the security of the American workforce. Eventually, U.S. policymakers will have to determine whether structural changes are needed to allow American businesses to better compete against foreign manufacturers and service providers that don't have to

Developed nations, therefore, must remain focused on education and training to keep their workers competitive. And U.S. shareholder activists, such as employee pension funds, can and should wield their investor clout. They must press companies to use offshoring not just as a cost-cutting tool but also as a way to transform their businesses so as to maintain more stable long-term employment levels back home. Like it or not, the phenomenon of offshoring is here to stay. The challenge now is how best to manage it.

What Japan Did For Detroit

YOU HAVE TO GIVE Toyota Motor Corp. credit for an heroic attempt at denying the obvious. Japan's largest auto maker in late December announced plans to produce more than 9 million vehicles

in 2006, which most analysts figure means it could surpass General Motors Corp. as the world's largest auto company. Since then, a few frenzied cries have arisen about Japan's looming dominance of the U.S. auto market, and Toyota shifted its rhetoric into reverse. On Jan. 10, James E. Press, president of Toyota Motor Sales U.S.A. Inc., stated contritely that Toyota has no desire to overtake GM, the world sales leader, going so far as to laud ailing GM as "a global icon" that will emerge from its troubles even stronger.

If this all sounds familiar, you're right. In the 1980s, America was up in arms over the success of Japanese manufacturers threatening U.S. auto jobs. Politicians rail, Union members rallied. And more than a few Toyota Corolla and Datsun B210s were trashed by angry protesters. But the crusade, however well-intentioned, was always doomed to failure because it attempted to put the primacy of national borders above the wisdom of the marketplace.

Of course, most Americans wanted auto jobs to stay at home but not if the cost of such national loyalty was settling for expensive, less reliable cars. Lulled by years of competing in a relatively captive market, American auto makers initially misunderstood that fact. Today it's Manufacturing 101.

The simple truth is that both the U.S. consumer and Detroit auto makers have benefited mightily from the Asian competition of the past quarter-century. Consumers got higher quality, smarter styling, better fuel economy, and a lot more value for their car-buying dollar. Detroit, for its part, was forced to face up to its out-of-control costs and lagging quality. True, Japanese nameplates like Toyota and Honda now capture about 30% of the U.S. car market. But the stiff competition resulting focus on the customer have also left American carmakers better equipped to compete in the future. Toyota Press and other executives at Asian car companies may be loath to say that publicly, but we aren't. However painful is an important lesson for Detroit—and for America.

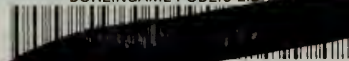
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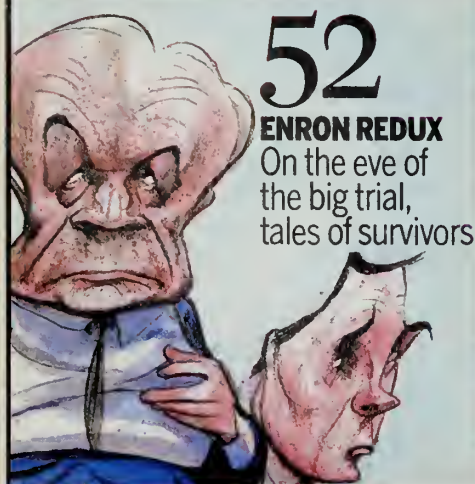
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 and managers abusing their access
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 are bidding big
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"HENDRICK'S" WON

THE GIN CATEGORY...

—THE WALL STREET JOURNAL

THE WALL STREET JOURNAL

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Taking it the way
at this year's
Consumer
Electronics Show

Eight Tech Trends for 2006

What does this year have in store for the technology industry? This **Online Special Report** finds eight key trends that will go a long way toward answering that question, starting in your living room. That's where **a war is under way** between makers of PCs and consumer electronics to sell you the next wave of home-entertainment gear. We also look at **"social search"**: Could it be Yahoo!'s answer in the fight against Google? Rounding out the big eight, we examine what's next for innovative wireless services, why the Web may be the new Hollywood, the proliferating security threats to personal computing, how tech hiring will shape up in 2006 (overall, quite well), why this will be a monster year for game consoles, and Microsoft's coming new operating system, Vista. You'll find this forward-looking special report at www.businessweek.com/go/8trends



Gates & Co. have Vista on the horizon

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"A million dollars isn't what it used to be."

—James Joseph, owner of a Century 21 brokerage in Whittier, Calif., to the Los Angeles Times about how 1 of 13 California homes sold for at least \$1 million in 2005

BY DAN BEUCKE

LOW-UPS KE PROMISES ROBE IN LOMBIA

COLA MAY BE giving d in its battle with e crusaders. The vity of Michigan and e have suspended sales ce products, its unwill- ss to allow outside y of worker tions at g plants in bbia.

S dent activists contend oke turned a blind eye ht bottling employees killed by right-wing ilitaries. Coke and its rs maintain that's f, saying violence st union workers was a oduct of the country's ar ("Killer Coke" or



Innocent Abroad?" Jan. 23).

But in a Jan. 19 letter to the University of Michigan's board of regents, Coke revealed that it is setting up a third-party assessment in Colombia. That group, which Coke plans to have in place by the end of March, would include representatives from labor, nongovernmental organizations, "and our most vocal critics," Coke says.

A University of Michigan spokesperson says administrators are reviewing the proposal. Some critics say it would be better for the company to extend a strong human rights policy to more bottlers. A Coke spokeswoman says its six largest bottlers have agreed to its code of business principles and that "we're rolling it out to the other bottlers." —Dean Foust



EXECUTIVE SUITE

A Social Strategist For Wal-Mart

WANTED: "AN INNOVATIVE, OUT-OF-THE-BOX THINKER" to "help pioneer a new model of how Wal-Mart works with outside stakeholders, resulting in fundamental changes in how the company does business." That's the description **Wal-Mart Stores** has on its Web site for a new post of "senior director of stakeholder engagement." The world's largest company has struggled to respond to critics of every stripe, from environmentalists to sweatshop activists. It has taken steps to change its behavior by, for example, working with suppliers to reduce packaging waste. "We're trying to centralize our [social responsibility] efforts," says spokeswoman Sarah Clark.

The new position also appears to elevate such efforts to a greater level of responsibility. The hire will report to Wal-Mart's vice-president for corporate strategy and "will play a critical role in helping the company...create a new model of business engagement that uses market-based changes to create societal value," the posting says. Still, it's not clear how much Wal-Mart is willing to tinker with its low-cost, low-price strategy to satisfy critics, says World Monitors CEO Scott Greathead, who advises companies on social responsibility. —Aaron Bernstein

BIG PICTURE

ISHING THE RESUME Execs still covet a stint ig-company boards, but outfits like Google Indian outsourcer InfoSys are valued, too.

QUESTION: "Which company board would provide the most valuable experience for a top CEO?"



GE	44%
GOOGLE	27
TOP VC FIRM	11
GM	5
INFOSYS	5
MICROSOFT	4
CITIGROUP	2
NYSE	2

Stan & Timbers survey of 163 senior executives

MARKETING MARCHES ON

BLADE RUNNERS Since Gillette rolled out its "safety razor" a century ago, it hasn't stopped innovating—or finding new ways to sell more blades (page 44). With the ad campaign for the five-bladed Fusion set to kick off at the Super Bowl, we take a look back at Gillette's razors and marketing claims. —William Symonds



PRICE PER REPLACEMENT BLADE(S)*

Original Safety Razor (1903, single blade) "Will hold its edge for 20 or 30 shaves"	\$0.05
Trac II (1971, two-bladed cartridge) "Two blades are better than one"	\$0.20
Sensor (1990, spring-mounted blades) "Can sense and adjust to the contours of your face"	\$0.79
Mach3 (1998, three blades) "You take one stroke, it takes three"	\$1.63
Fusion (2006, five blades plus a trimmer) "The comfort of five blades, the precision of one"	\$3.00

Data: Global Gillette

* Not adjusted for inflation

BLOGSPOTTING

HOW TO BYPASS BIG BROTHER

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» **WHY READ IT** In many countries, including China, blogging can lead to jail time. Read this to gather advice—in English, Chinese, Arabic, or Farsi—on how to blog while being truly anonymous.

» **NOTABLE POST** From a guide to anonymous blogging in Malaysia: "Another social option is to use Adopt a Blog, <http://www.adoptablog.org/>. Designed primarily for blocked blogs in China, you can contact this service to request that someone outside your country host a blog on their server. The server hosting your blog is unlikely to be blocked...."



GREEN IS GOOD...RIGHT?

WHOLE FOODS MARKET, mindful of its environmental rep, says it will offset energy used in its stores by investing in renewable wind energy credits. But that has raised some dust. Shareholder Mark Orlowski points out that the credits—which subsidize wind and are traded for conventional power—average 2¢ to 3¢ per kilowatt hour more. By buying 458,000 megawatt hours, the grocer presumably got a steep discount. Still, even with a discount, Orlowski estimates that Whole Foods could shell out up to \$10 million extra. Whole Foods won't comment. Craig Hanson, a senior associate at World Resources Institute who worked on the deal, says that figure is way too high. But Orlowski says Whole Foods should be more concerned about turning off lights and other conservation efforts. —Jessi Hemm

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CELL-PHONE STOCK TRADERS

When the Tokyo Stock Exchange tanked and was forced to shut down early on Jan. 18, some of the strain came from investors placing sell orders with the flick of a cell-phone button. That reflects the latest twist in Japan's love affair with technology. In November the value of trades made via mobile phones by brokers Matsui Securities, E*Trade Securities, and Monex—three of Japan's major online brokers—hit 1 trillion yen (\$8.7 billion) for the first time, up 90% over the year before.

Wireless trading reflects the way Japan's mobile-phone industry evolved. In the 1990s, pricey per-minute charges over regular phone lines discouraged Internet access at home. Many found it cheaper to sign up for Web-enabled cell phones instead. Now brokerages are rushing to beef up cell services. At Kabu.com, account holders can check stock prices, build charts, and read prospectuses on phones. And in February, E*Trade plans a lottery for customers who want to buy into IPOs.

—Kenji Hall and Ian Rowley

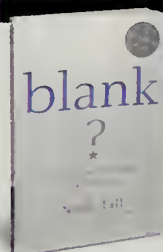
CLASS NOTES BIZ MAJORS GET AN F FOR HONESTY

SUDDENLY THE BUSINESS scandals of the past few years make a lot more sense. Research by the Center for Academic Integrity, a think tank affiliated with the Kenan Institute for Ethics at Duke University, shows that undergraduate business students do more cheating than just about anyone else. The survey of nearly 50,000 students at 69 schools found that 26% of business majors admitted to serious cheating on exams, and 54% admitted to cheating on written assignments, which includes plagiarism and poaching a friend's homework.

Bad as that is, business students didn't rank as the worst cheaters. That

distinction belonged (ahem) to journalism majors, 27% of whom said they cribbed answers. The most honest group? Those in the sciences, where 19% reported cheating on tests. The results come from surveys conducted over the past three years by Donald McCabe, a management professor at Rutgers Business School and founder of CAI.

McCabe says cheating increased since he began doing surveys 15 years ago. He partly blames technology for making cheating easier. Papers can be downloaded off the Internet, and answers text-messaged to friends, he adds that a "disturbing" number of students use recent corporate and political scandals to justify their behavior. —Helena



COMING OFF THE POPULARITY of Malcolm Gladwell's *Blink: The Power of Thinking Without Thinking*, HarperCollins on Feb. 1 will publish the parody *Blank: The Power of Actually Not Thinking* A by "Noah Tall"—actually AdWeek columnist Lewis Grossberger and ESPN Books editor Michael Solomon. In the same spirit, here are some pop-economics titles we'd like to see. —Jena McGraw

REAL BOOK	PARODY	SYNOPSIS
<i>The World Is Flat: A Brief History of the Twenty-First Century</i> , Thomas L. Friedman	<i>The World Is Phat: A Brief History of the Hip-Hop Century</i>	In <i>Phat</i> , readers journey beyond the East and West Coast scenes to the far corners of the globe, witnessing how hip-hop is connecting previously isolated cultures. Meet posse members whose jobs have been outsourced and the Indian emcees who rhyme through the night for a tenth of the beat.
<i>Freakonomics: A Rogue Economist Explores the Hidden Side of Everything</i> , Steven D. Levitt and Stephen J. Dubner	<i>Geekonomics: A Rogue Engineer Explores the Premium Side of Everything</i>	Which is more dangerous, a private jet or a private yacht? What do California real estate agents and Toyota Prius drivers have in common? These might not sound like questions an average code jockey would ask. But <i>Geekonomics</i> bucks conventional wisdom, examining what's possible when you've got thousands of shares of GOOG at more than \$400 a share.
<i>The Wisdom of Crowds</i> , James Surowiecki	<i>The Mob Is Wiser Than You Are</i>	In simple prose ("Fuhgeddaboutit!"), <i>The Mob</i> explores as wide-ranging as forensic science and viticulture to explain why a few wise guys know more than the rest of us. Why mobsters kiss? Why the brightly colored suits? The answers offer an experience that readers won't be able to refuse.

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With China's and India's automotive economies heating up, the writing is on the wall: \$100-a-barrel oil and up."

—Lloyd Weaver
Harpwell, Me.



WHAT DRIVERS REALLY WANT

AS SOMEBODY WHO reached adulthood in Europe, I can assure readers that the "hot market in Europe for stylish and increasingly performance driven compact cars" has been around for decades ("Dream machines," Cover Story, Jan. 16). It is, in fact, the reason that in a half-century of driving I have never owned an American-designed or -manufactured vehicle. If you really wanted to write about design, rather than style, you would have pointed out that what's new in Europe is that half of those peppy, stylish vehicles are diesel-powered, and hence much more fuel-efficient and less polluting.

—Andrew Allison
Carmel, Calif.

I AM PESSIMISTIC about the future of computer systems that directly control the motion of an automobile. These are complex systems that inevitably will produce unintended consequences, in addition to suffering from programming bugs. A percentage of these will result in situations that create liability for the manufacturer, among others. This liability is likely to exceed that created by simpler, current sys-

tems, such as cruise control or automatic braking systems (ABS).

—Daniel B. Kapu
Delafield, Ill.

WITH CHINA'S AND INDIA'S automotive economies heating up, the writing is on the wall: \$100-a-barrel oil and up. The article glosses over what really needs to be done: achieve far higher vehicle efficiencies. If we don't do it, as we have, foreign manufacturers will do it for us and control the intellectual property, as well. When they control enough of the best-working patented automotive technology, our auto industry will go bankrupt, cause consumers will not buy second-hand vehicles in efficiency.

—Lloyd Weaver
Harpwell, Me.

UNFORTUNATELY, FEATURES I want are rare to nonexistent. I would like a bench front seat, which used to be common even in the smallest of vehicles. I prefer vinyl seats and floor, because they are much, much easier to keep dry and clean (do your own experiment). I would prefer a decent trunk lid, to avoid bulky items from the store or

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ReadersReport

sales—for whatever reason, designers provide a huge rear dash instead. It would be nice to see the front end and the rear end of the car while in the driver's seat. Since the newer designs do not allow this, I would also appreciate right and left mirrors that fold (parking spaces don't seem to take into account the size of today's mirrors).

—W. Connor
Tampa

IN "SEXY OR SENSIBLE?" on automotive choice, David Kiley gets the "Teenage Terror" category wrong. While both the Honda Civic and the Mazda 3S have good safety numbers, they're good numbers for cars of their size. Better to put Junior and his sister in a used Volvo than either of these admittedly delicious go-carts.

At the other end of the spectrum, Titans of Industry who decide to treat themselves well don't strap themselves into a Porsche 911, or anything like it. Top-of-the-line Audis and BMWs abound. I know one "TOI" who bought a Miata, but he drove it through a snowstorm and realized he was feeling suicidal, so he dumped it and got the largest Mercedes-Benz available to take its place.

—Mike Connelly
Brunswick, Me.

YOUR FIVE "SEXY OR SENSIBLE?" buyer categories left out a major niche: retiring baby boomers. As a possible leading indicator of this group (retired since 1988), I recently shopped around for a new set of wheels. The long wait for my first choice, a Prius, detoured me toward the Honda Element and Scion xB. I settled on the xB, largely because of the ease of entry and exit, plus good gas mileage. The Honda and Scion salesmen—both quite young—told me with some awe that sales of these cars, designed for Gen X, were split between customers under 30 and over 60. We geezers came as a big surprise!

—Theodore B. Merrill
Shelburne Falls, Mass.

"SEXY OR SENSIBLE?" says today's dreams are not of your father's Oldsmobile. Well, guess what? It's not all about new cars. My "teenage terror" just wants a car, and it happens to be a very dreamy used Impala! As the song goes, "any dream will do."

—Joseph Drago
Western Springs, Ill.

WHY THE TRANSGENIC FUTURE IS SO SCARY

IN "CROSSING THE gene barrier" (Spe-

CORRECTIONS & CLARIFICATIONS

"HP's ultimate team player" (Information Technology, Jan. 30) should have said that Ann Livermore received a Morehead (not Morehouse) Scholarship from the University of North Carolina at Chapel Hill.

"The new kingmakers" (People, Jan. 30 issue) should have said that in early February (not January), 2005, Patricia C. Dunn, chairwoman of HP's board of directors, called recruiters after former HP CEO Carly Fiorina resigned.

In "Danger: Falling prices" (Books, Jan. 30), reviewer Michael Arndt stated that author Charles Fishman should tell readers whether or not Wal-Mart Stores Inc. had refused to respond to his questions. In fact, Fishman states in his footnotes that Wal-Mart "consistently declined" to "participate in the reporting of the book."

"Is GM on the road to a board fight?" (News: Analysis & Commentary, Jan. 23) incorrectly stated that General Motors' stock price has fallen 42% in the past month. At the time the story was published, the stock price had fallen 42% in the past year.

"A real-life Willy Wonka" (Books, Jan. 23) refers to Corning, N.Y., as a town named for its corporate landlord. Actually, the glass company took on the name of its town.

cial Report, Jan. 16), the sidebar, "What's ethical and what isn't" mentions that the National Council of Churches USA would like a "governing body to review transgenic and brain-cell experiments" that "should include religious leaders and scientists." The possibility of a future filled with monstrous transgenic chimeras is pretty scary. Far more chilling is the possibility of "religious leaders" overseeing the work of scientists. Although peer review and ethics training are not perfect, they are far superior to ceding scientific advancement to archaic, arbitrary beliefs.

—Todd Faulls
New York

MORE WEAPONS TO BATTLE CHILDHOOD OBESITY

CATHERINE ARNST is right that parents must open their eyes to childhood obesity ("Helping your kid slim down," Personal Business, Jan. 9). However, child development and crisis experts are realizing that we must also attack the underlying emotional roots of overeating caused

by unprecedented modern stresses children. It's not only what our kids eat—sometimes it's what's eating kids. Now, more holistic efforts are starting to provide parents and kids with health eating information and problem-solving resources that will help defuse the obesity bomb before our kids "blow up." Parents can find healthy-eating and family-communication tips at KidsPeace.org. Kids can find tips and resources to eat healthy, work out stresses, and avoid eating disorders at TeenCentral.net.

—C.T. O'Donne
President & CEO
KidsPeace
Bethlehem, Pa.

A NEW APPROACH TO ALASKA'S NATURAL GAS

GIVEN THE COMPLEXITIES of Alaskan natural gas fiasco, perhaps a new approach is required that can create a win-win situation for all ("Memo: Rex Tillerson," News: Analysis & Commentary, Jan. 9). Some have determined that Alaskan natural gas could be converted into a superclean diesel fuel or order of 1 million barrels a day (compared with an estimated 1.4 million barrels a day output from the Arctic National Wildlife Refuge).

Given Exxon Mobil Corp.'s technical skill in the conversion of natural gas to liquids plus its experience with its natural gas-to-liquids Qatar project, going to Alaska should be a snap. The existing oil pipeline might be adequate for transporting this liquid to Valdez. The addition of 1 million barrels a day of transportation fuel would reduce imports by the same amount and improve the trade deficit.

—Augie P.
Alpharetta, Ga.

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Chuckling the Checkbook

WHEN PETER KIGHT, a former college decathlete, began managing health clubs in Texas in the late 1970s, he was repulsed by the high-pressure sales tactics gyms used to keep revenues flowing. Realizing that many new members drop out after a few months, clubs leaned on recruits to pay a full year's fees up front.

Why, asked Kight, couldn't they arrange to have monthly dues deducted from members' checking accounts? Kight quickly began negotiating with local banks to do just that—forever changing how millions of Americans pay bills.

In 1981, working out of his grandmother's basement in Columbus, Ohio, Kight forged a business out of electronic bill paying. Hiring a programmer to write software for his venture, which in time became CheckFree, he focused first on automatic payment of recurring bills at several dozen local health clubs. Then he turned to insurance firms that were looking for a predictable way to collect customers' monthly premiums: "We taught the marketplace how to do standing-order payments." But when he sought help with funding, more than 30 venture capitalists turned him down. (One called his operation "an interesting idea by a broken-down ex-jock.") So Kight turned back to the insurance companies to underwrite the next leg of his company's growth.

That came with the spread of personal computers in the mid-1980s, giving Kight the necessary conduit between consumers and billers. But some major billers were still unwilling to accept electronic payments, so Kight had no choice but to send paper checks on behalf of consumers who had authorized him to pay their bills. To pressure the billers, he made sure all of his customers' checks arrived at the same time, in large mailbags. He dubs the strategy "paper pain," and says that "it eventually did work."

In the early 1990s, major banks and software companies jumped into the bill-paying game, including a consortium comprised of Microsoft, Citicorp, and First Data. "They all thought they could create a technological shortcut," says Kight, "but there is [none]. They underestimated how hard the details of the business are." Foremost, he says, is learning the idiosyncrasies of the different financial institutions and adapting to them. Today CheckFree handles nearly 800 million transactions a year, giving it more than 50% of the online bill-paying market and more than \$750 million in revenue.

As a philosophy major at California State University in Bakersfield in 1977, Kight wasn't a devoted student: "My major was the pole vault," he jokes. He dropped out when he tore a hamstring in senior year. To pay his rent, Kight hosted a bodybuilding competition at a nearby auditorium, which led to a position as editor of *Muscle Digest*. Kight spent the next couple of years writing about legendary bodybuilders, including a rising star named Arnold Schwarzenegger.

Now Kight's goal is to provide the back-office infrastructure for Wall Street firms to offer

Kight's idea: Make it easy to pay bills online

"separately managed accounts wherein money managers create customized portfolios for each investor. In the past, these individualized portfolios have been more costly to create than traditional mutual funds. I'm automating and

streamlining the handling of each portfolio, Kight believes he can change the way Wall Street manages money. "We're two years away from allowing separately managed account investors to reach the same low costs as the mutual fund industry," he says. Just as electronic payments are replacing checks, "a tailored account is going to win out over mutual funds." ■

—By Dean



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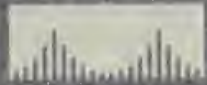
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BY STEPHEN H. WILDSTROM

Amping Up Your Laptop

Desktop computers have always outperformed laptops, and lately the gap has been widening. A new family of Intel processors, branded the Core Duo, is designed to bring desktop-like performance to the latest laptops. But they're hitting the market at a time when changes, in particular the upcoming Windows Vista, present buyers with tricky choices.

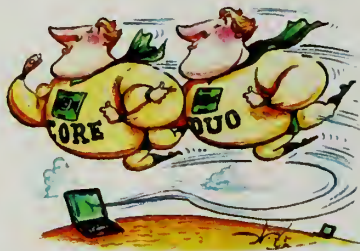
Laptops need a boost. Not only are they doing more with multimedia content, but the software needed to keep a computer happy and healthy, including Windows itself and an assortment of security tools, makes huge demands on processors. The Core Duo (branded Centrino Duo when bundled with other Intel chips) follows the lead of the Pentium D desktop chips released last year, squeezing two processors onto a single piece of silicon. All laptop makers will be bringing out Core Duo models in coming weeks. The chip will also find its way into space-saving desktops designed for very quiet operation, including the new Apple iMac, which I will review in detail next week.

The Core Duo lives up to its performance claims. I tried it in a preproduction version of a Gateway M465 (from \$1,399). While the laptop's 15.4-in. wide-screen display and 5.7-lb. weight make it bigger and heavier than a notebook I would want to travel with, the performance was impressive. It breezed through processor-intensive tasks, such as rendering 3-D video transitions in Adobe Premiere Elements and applying special effects to high-resolution photos using Ulead PhotoImpact. Even while connected to a wireless network and running anti-everything protection, there were no hangups.

BATTERY LIFE IS A MIXED BAG. Manufacturers have been testing designs using the new chip, and they report everything from slightly more running time than with the predecessor Pentium M processor to significant declines in battery life. The difference appears to result mainly from the choice of a graphics adapter, the system responsible for putting images on the display. Here is where things get confusing for buyers.

Computer manufacturers can design systems to use the Core Duo in two ways. The first is an all-Intel approach, where the company's own graphics chip is built right into the motherboard and taps the PC's main memory to process video. The other choice is to buy a graphics adapter from either nVIDIA or ATI Technologies. A separate adapter gives superior performance, but Intel's integrated graphics provides significantly better battery life.

The complicating factor is the likelihood that, at some point



during the lifetime of your new laptop, you want to upgrade to Vista. This software includes the first major overhaul of Windows appearance in a decade. But some of the most dramatic changes, including semi-transparent windows and animations that not only look cool but are designed to make the software easier to use, will work only on high-end graphics systems. Lesser PCs will suffer. Microsoft's documentation puts it, "degrade gracefully," meaning users will see an interface that resembles the one on high-end systems, but some features will not work.

Intel's Core Duo chip boosts power but may compromise battery life

The problem is, no one is sure whether or not the graphics firepower of nVIDIA or ATI will be necessary. Microsoft claims it expects all features of Vista to be available on the newest Intel integrated graphics, but Sean Maloney, director of Intel's Mobility Group, says: "We don't know yet." Current test versions of Vista run only on high-end systems. The situation should be clarified when Microsoft offers broader hardware support on the next major test version, which will probably be released in late spring.

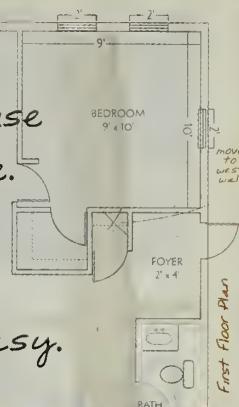
The best advice I can offer at this point is that if you are buying a notebook soon and want to be sure you can get all the features of Vista, choose one with a graphics adapter from nVIDIA or ATI. This will mean putting up with less battery life, and it also rules out the smallest laptops, which simply don't have room for a separate graphics card. There's no question Microsoft and Intel will clear up the confusion, but for now, it hits buyers with a vexing choice. ■

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Rockers, Keep Your Day Jobs

To quote the sages of AC/DC, rock 'n' roll ain't noise pollution. And now it ain't that good a business, either. ¶ In 2006 the mainstream rock act that reliably sells platinum, or 1 million copies, is an endangered species. Subtract those established in eras just past, such as U2 and Green Day, and the population shrinks further. This is a relief to savvy listeners—thousands

of independent-label flowers now bloom—but it's hell on major record labels, which still need massive sales from franchise bands. Rockers favor albums over singles (famously, Led Zeppelin never released *Stairway to Heaven* as a single), and albums reap bigger profits for their labels. While rock helped build the big labels' superstructure in the 1960s and 1970s, now chunks are falling off that facade.

In recent weeks, New York and Philadelphia each lost their sole radio station devoted to "modern rock," the format most likely to play new rock bands for a mass audience, and Phoenix lost one of its two. This follows a year in which some seemingly sure-thing rock releases, specifically from Audioslave and the White Stripes, notched less than half their previous CDs' unit sales. These bands are hardly finished, but they show how achieving and maintaining rock superstardom is a different beast today.

ONCE IT WAS ALL MUCH EASIER. There was a simple symbiosis among rock radio, record labels, and the arena-concert circuit. In the 1970s their interplay enabled the emergence of a new class of megastar band like Led Zeppelin. But of nearly equal importance to the music business, it also gave rise to a cadre of second- and third-tier rock bands that, despite critics' complete derision, sold zillions of records. These days the names Grand Funk Railroad and Foghat are primarily punchlines, but in the '70s they scored a total of 17 gold or platinum albums. They were also big concert draws, stoking massive fan bases at the sleazy, smoky arena shows that were sort of spiritual, sort of Satanic. (N.B.: Grand Funk's records are better than you think.)

This type of band no longer exists and neither do the conditions that fostered their ascent. Rock radio is increasingly a victim of fragmenting demographics. The sole genre posting sales gains last year, according to Nielsen SoundScan, was Latin. Arena rock shows that once promised spectacle for less than a sawbuck have bloated into elite affairs resembling



closed corporate events. Average ticket price for a show on the Rolling Stones' 2005 tour: \$134. It's no surprise, then, that the arena-concert business has shifted decisively toward greatest-hits revues by graybeards such as the Stones and the Eagles.

Today's key entry points for music consumers are iTunes and ringtones. The former favors singles over albums and thus further unbundles rockers' preferred medium, and the latter is peculiarly inhospitable. None of the top 10 ringtone downloads of 2005 came from rock acts. Hip-hop now owns the artist-as-icon phenomenon. Rock hasn't minted a star with the pop-cultural legs of

Cent or Eminem in this century.

GRAND FUNK RAILROAD

The days of second-tier yet platinum-selling acts are over

There are benefits to the splintering of musical hegemony. Broader access to music, be it from online recommendation engines or satellite radio, gives

consumers many more choices than they had in the old days. One big story of 2005 was the wildfire success of Clap Your Hands Say Yeah, which parlayed blog buzz into selling something like 50,000 copies of a self-released CD and an appearance on *Late Night with Conan O'Brien*.

Some newish rock bands have established themselves as franchises reminiscent of another era. (Coldplay leaves the cognoscenti, ah, cold, but its sales make Capitol Records happy.) Still, the big business plays for today's bands are complex revenue-sharing deals that monetize everything down to T-shirt sales, as Korn did in pacts with EMI Group PLC and concert promoter Live Nation Inc. Once it was easier. And so somewhere the thinning bangs of a music hang limp as he quietly sobs at his desk, overwhelmed by sudden nostalgia. Who'd have thunk he'd miss Grand Funk this much? ■

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The Barker Portfolio

BY ROBERT BARKER

Skip This Fruit Plate

Carmen Miranda and me. We love bananas. Even more I love pineapples, especially those "gold" ones, the thought of which makes my mouth water. Fresh Del Monte Produce, which popularized the variety and is its top purveyor, knows a good thing. So it has trademarked its Del Monte Gold Extra Sweet pineapples,

a label I search for at the supermarket. Fresh Del Monte, not to be confused with Del Monte Foods, a separate food processor, also is a leading global seller of fresh bananas. Then, there's Fresh Del Monte's common stock. It lately generates a golden 3.6% dividend yield—even more mouth-watering, perhaps, than any banana-pineapple salad.

So why would I avoid Fresh Del Monte's shares? At 22, they look like a bargain, down from nearly 34 in February, 2005, and close to their 52-week low. Shunning Fresh Del Monte may seem stranger still, given that it might be up for sale, a market rumor that the company, via the New York Stock Exchange, declined to comment on. (Fresh Del Monte, which is based in the Cayman Islands but has executive offices in Coral Gables, Fla., also did not respond to my several calls.) My distaste for the stock stems only in part from the company's opacity. A bigger worry for prospective investors is the company's fundamental outlook and valuation.

HERE'S WHAT I MEAN: Fresh Del Monte has yet to post its full 2005 results, and while it expects to show a sales gain, earnings per share will decline, to between \$1.90 and \$2 from \$2.14 in 2004. For the current year, the Wall Street consensus is for no better than flat profit performance. But even that might be too rosy. Heather Jones, an analyst at BB&T Capital Markets, notes in a Jan. 11 report that a new tariff regime in Europe figures to raise Fresh Del Monte's costs of selling there. Other costs, including shipping and energy, also are subject to hikes this year, further pressuring profit margins.

To be generous, let's assume that Jones's bearish take is wrong. Assume instead that the consensus, flat earnings this year compared with 2005, is closer to the mark. In that case, with an enterprise value—that is, market capitalization plus net debt—of

nearly \$1.6 billion, Fresh Del Monte is trading in the stock market at 10.7 times its earnings before interest and taxes (EBIT) over the past four quarters, according to Capital IQ unit of Standard & Poor's. How does that multiple compare? The most analogous company is Chiquita Brands International. Based in Cincinnati, it's a little bigger by revenue (\$3.7 billion, vs. Fresh Del Monte's \$3.3 billion) but has posted noticeably higher EBIT, \$221 million, compared with \$147 million at Fresh Del Monte. So that means anyone purchasing shares of Fresh Del Monte is paying a sharp premium to the 7.6 times EBIT command by Chiquita (table).



But what if a private-equity firm or an industry rival (one rumored suitor, Dublin-based Fyffes, told me it had no comment on the speculation) opens its wallet to buy the company outright? How might it be valued then? As Boston Scientific and Johnson & Johnson have shown in their battle for Guidant, almost any price might be paid in the heat of a bidding war. But we can look back to the March, 2000 going-private deal for Dole Food, another close competitor to Fresh Del Monte in pineapples, bananas, and mangoes, to see what cooler heads decided. After negotiating with independent directors of the board, Chief Executive David Murdock wound up buying out public shareholders at a price that valued the company at nearly \$2.4 billion. That worked out to just 9 times EBIT.

No question, I fancy bananas and gold pineapples, too. Whenever Fresh Del Monte's toothsome dividend yield whets my appetite, however, I'm just going to swallow and pause a beat, and start humming the old tune: "Y We have no bananas. We have no bananas today." ■

E-mail: rb@businessweek.com

Some Food For Thought

COMPANY / SYMBOL	PRICE*	ENTERPRISE VALUE	EV/EBIT** (MILLIONS)
Chiquita Brands Int'l CQB	\$18.95	\$1,694	7.6
Fresh Del Monte Produce FDP	22.11	1,575	10.7

*Jan. 23

**Ratio of enterprise value to earnings before interest and taxes

Data: Capital IQ

JAMES C. COOPER

Bernanke May Have His Work Cut Out for Him

If the economy doesn't cool down, rates could go higher than investors expect

U.S. ECONOMY Ben Bernanke's first day on the job as chairman of the Federal Reserve Board will be Feb. 1, following the Fed's upcoming meeting on Jan. 31, which will be Alan Greenspan's last. Bernanke will have to hit the ground running. Having not attended that meeting, he must then turn around two weeks later and

over congressional testimony on the Fed's semiannual report on monetary policy. Wall Street will be all ears. At first blush, Bernanke could not be taking over at a better time. The Greenspan Fed has already done the heavy lifting on policy tightening, having boosted its target interest rate from 1% to 4.5%, assuming a widely expected quarter-point hike on Jan. 31. Inflation, according to the Fed's preferred gauge, is in Bernanke's comfort zone of 1% to 2%. And the economy appears to have slowed in the fourth quarter, based on growth in gross domestic product, a necessary condition for maintaining tame inflation. Nothing for the Bernanke to do but sit back and put its feet up, right?

Smart investors know that perfect Fed policy is rare, that's what most investors seem to be expecting. For example, the latest UBS Index of Investor Optimism jumped sharply to its highest reading since June, 2004. The survey was taken from Jan. 2-15, a period including the, but not all, of the recent runup in oil and gasoline prices. A bit less than two-thirds of those surveyed said it was a "good time to invest in the financial markets."

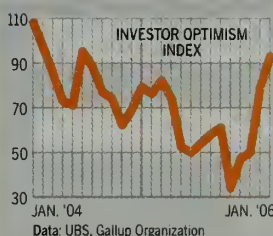
In particular, investors don't seem overly concerned about inflation or interest rates. UBS gave respondents a list of 12 issues for 2006 and asked which were "extremely important." Interest rates and inflation ranked eighth and ninth, respectively. Ranking higher: energy prices, health-care costs, availability of jobs, Iraq, terrorism, job outsourcing, and the federal deficit. Rising-market conditions, which are heavily dependent on interest rates, stood dead last. The results suggest that investors believe inflation will stay tame and that the Fed will finish raising rates.

EXPECTATION OF PERFECT POLICY from the Fed is one of the biggest risks in the outlooks for both the financial markets and the economy. After the expected 0.31 hike, the markets look for no more than one additional quarter-point increase, to 4.75%, in the Fed's target rate, and the futures markets are hinting that the Fed may even cut rates at some point in the second half. Overall, this is a highly favorable scenario for both stocks and bonds, and one that is consistent with continued, if moderate, economic growth.

But what if the economy doesn't cooperate? Given the soundings from the latest data and business surveys, the greatest risk right now is that the Fed has not yet tightened policy enough. Compared with past periods, financial conditions are relatively easy. Despite the Fed's 3.5 percentage points of rate hikes, its inflation-adjusted policy rate is still no higher than its historic average. That

average is generally thought to be a level that makes policy neutral, neither stimulating nor restricting economic growth. However, long-term interest rates remain low enough to be stimulative. For example, 30-year fixed mortgage rates averaged only 6.1% for the week ended Jan. 20, still a very attractive financing rate.

INVESTOR CONFIDENCE IS AT A 1½-YEAR HIGH



Also, despite the Fed's rate hikes and the runup in oil prices, the credit markets see even less risk in the economy now than they did when the Fed began tightening policy. One measure of risk is the gap between the yield on a moderately risky 10-year corporate bond and that for a riskless Treasury note. The wider the gap, the riskier the loan. This spread remains very narrow, however, and it is smaller now than it was at the onset of the Fed's rate hiking in June, 2004.

MOST IMPORTANT, OVERALL DEMAND by consumers and businesses remains strong. Consumers are getting support from improving labor markets, as signaled by the extremely low level of new jobless claims in January. Both consumer and corporate balance sheets are solid, and corporate cash flow is abundant. Moreover, demand overseas is picking up, as the euro zone and Japan find firmer footing and as the dollar is set to decline further.

Continued strength in demand was one of the findings from the National Association for Business Economics quarterly Industry Survey with responses from Dec. 15 through Jan. 10. The NABE says that demand for goods

and services accelerated last quarter. A net 54% of the 142 members surveyed reported increasing demand, the highest reading since the second quarter of 1997, and improvement was evident across all major sectors.

In addition, the NABE said price pressures remained elevated, profit margins had improved, hiring plans for the next six months match the strength of recent quarters, and capital spending plans for the coming year were solid. All in all, it is more a picture of acceleration than moderation, and one likely to cause some discomfort among Fed officials if the data in coming months confirm that the economy remains strong enough to make future inflation a threat.

ENERGY IS ONCE AGAIN adding to those inflation worries. In recent days, the price of oil has jumped into the \$65-to-\$70 range on fears of possible supply disruptions from Iran and Nigeria. Based on the historic relationship between oil and gasoline prices, if oil stays in that zone, average pump prices could rise from \$2.34 per gallon on Jan. 23, into the range of \$2.60 to \$2.80. That updraft would reignite concern over the pass-through of higher energy costs into prices broadly.

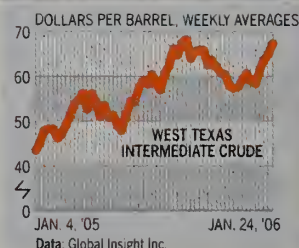
Amid strong demand and tighter labor markets, it's easier for companies to pass along higher energy costs. Keep in mind that demand by consumers and businesses held up remarkably well, with oil in the range of \$55 to \$65 per barrel last year. Oil at current levels mainly reflects strong global demand, and global economic growth this year will equal or exceed last year's pace.

The real danger to the economy and inflation is oil at \$100 per barrel, the result of a classic supply shock, should actions in Iran or Nigeria result in a substantial drop in oil flowing to world markets. That would severely complicate the Fed's goals. Unlike high oil prices driven by strong demand, supply disruptions not only fuel

inflation. They also quickly and severely distort business costs, stymie production, and generate uncertainty that tends to freeze decision making and limit gains in investment and hiring.

Energy certainly will play a role in the Fed's decisions this year, but the greater concern of policymakers will be more basic. The Fed wants

HERE WE GO AGAIN, MORE OIL WORRIES



want to assure that demand does not strain the ability of business and labor to meet it. That's the standard recipe for greater inflation pressure. Policymakers will look mainly at the labor markets and wage growth for signs that demand and production remain in a healthy balance.

Watch the economic data closely over the next couple of months. If the numbers fail to imply that the economy is cooling down a notch, then the new Fed chairman could have a lot more work to do in 2006, a situation that would surely put a damper on investors' confidence.

HOUSING

Will Surging Supply Pop the Bubble?

FORECASTS OF the housing market's demise in recent years have been premature. The prolonged housing boom has been due not only to strong demand but also to restraint among homebuilders. Now, it appears builders are becoming more speculative as demand is set to wane.

During the second half of 2005, the supply of new single-family houses available for sale has been growing at the fastest pace since the mid-1980s. The surge in supply has corresponded with a gradual slowdown in sales and, until December, little adjustment in housing starts. What's more, the potential oversupply of new housing is most likely worse among multi-family buildings.

Housing starts for buildings with five units or more rose 11.4% from a year ago in December, but vacancy rates are at historically high levels, according to Fannie Mae.

Today's situation stands in contrast to the brief slowdown in late 2003 when a bump in long-term interest rates dampened homebuying. Inventories rose, but remained at relatively low levels. In 2003, "it was

safe to say that homebuilders had entirely avoided the temptations of speculative building," says FTN Financial chief economist Chris Low. "That is no longer true today."

Construction in December continued to grow despite new signs of cooler demand. The National

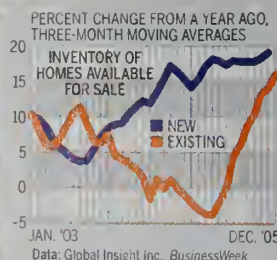
Association of Realtors' housing affordability index hit a 14-year low in November. Higher short-term interest rates are reducing the attractiveness of adjustable-rate mortgages.

Making matters worse for homebuilders is a surge in the number of existing homes for sale, up 20.6% from a year ago. The rising inventory will suppress overall home price appreciation. After registering double-digit gains in recent years, the median price gain in 2006 will be just 3%, predicts Fannie Mae.

As the housing market plateaus, speculative activity will evaporate. That's when housing should slow noticeably. Home sales could post the biggest annual decline since the fall in 1991. At that point, builders will scramble to stop projects, and big gains in construction hiring that have helped to drive the jobless rate lower could start to reverse.

—By James Mehring in New York

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Welcome Aboard, Steve On Jan. 24, Pixar agreed to climb on **Walt Disney's** flying carpet—for \$7.4 billion. Pixar CEO **Steve Jobs** will join the Disney board, a move that could transform the future of digital entertainment.

See "Steve Jobs' magic kingdom," page 62, and "Hi-Ho! Work for Disney or go?" www.businessweek.com/go/tbw

Ford's New Look Change or die. That's the mantra at Ford these days, championed by **President of the Americas Mark Fields**, the latest leader of **CEO Bill Ford's** bid to turn around his great-grandpappy's company. On Jan. 23, Ford reported a profit of \$2 billion but said its key North American auto operation leaked \$1.55 billion last year and has two years of red ink ahead. So it's cutting 14 factories and up to 35,000 jobs by 2012. It's also talking about shaking off a culture that left it overstocked with gas-thirsty SUVs



and creating one focused on nimbly making vehicles that customers actually want. Wall Street pushed shares up, although it wishes Ford would accelerate the shrinkage and execute deeper cuts, such as axing the **Mercury** brand or perennial money-loser **Jaguar**.

Meantime, with **GM** and Ford slimming down, **Daimler-Chrysler** didn't want to be left out. New **Chairman Dieter Zetsche** said he will dump 6,000 white-collar jobs in the next three years. And just to keep things interesting at GM, **Kirk Kerkorian** on Jan. 25 hiked his stake to 9.9%.

See "Chrysler slips out of cruise control," page 39, and "Realignment at the Big Three," www.businessweek.com/go/tbw

It's Still Knight's Nike Proving once again that it's easy to run Nike with founder **Phil Knight** around, **William Perez** quit on Jan. 23 after just 13 months on the job. See "Inside the coup at Nike," page 34, and "Nike CEO gets the boot," www.businessweek.com/go/tbw

Wall Street Worries Oil prices and earnings drops whacked the Dow by 213 points on Jan. 20, erasing gains for the year as bellwethers such as **Citigroup**, **Intel**, and **GE** turned in limp numbers. And on Jan. 25, poor December figures sent new signals that housing is slowing, which also depressed traders. But don't miss the sunny side of Street: Through Jan. 25, 64% of 162 companies in the S&P 500 reported profits above estimates, 18% matched estimates, and 18% missed, says Thomson Financial. S&P earnings are forecast to rise 14% in the fourth quarter, which would mark 10 straight quarters of double-digit gains. Not too shabby.

Birth of a Network Chalk one up for **Leslie Moonves**, the empire-building CEO. Moonves, whose company was bought by **Viacom** this year, engineered the merger of his 12 **UPN** network with another weak sister, **Time Warner's** **CW** network. Both target the young, giving the new **CW** (for CBS and Warner) network a lineup of shows like *One Tree Hill* and *Everybody Hates Chris* that play to the demo advertisers crave. CW, a 50-50 CBS-Time Warner venture, will trail the Big Four but will cover more than 95% of the country, with the CBS-owned 12 UPN affiliates joining 16 large-market stations owned by **Tribune Co.**, a long-time WB affiliate.

Albertson's Sells Out They're going to carve up the supermarket business like a turkey, and **Wal-Mart** is the reason it's so choppy. On Jan. 23, the grocer accepted a \$9.5-billion offer from a consortium with a complex plan. **Supermarket** will swallow 1,124 of the more successful markets, becoming the No. 2 U.S. chain. **CVS** will take about 700 standing drugstores, while investors led by **Cerberus Capital** will grab 655 properties for the real estate. Like most competitors, Albertson's has struggled against Wal-Mart's rise to top hot dog in the business. It remains to be seen whether Supermarket can do better.

See "A supermarket war in store" and "Supermarket strategy," www.businessweek.com/go/tbw

Two Faces of Google? One day, Google is the hero; the next it's in the cyber-doghouse. Privacy watchdogs lauded Google on Jan. 18 when it was revealed the company is fighting a subpoena for search data as part of the **Bush Administration's** antiporn drive. Other Net giants such as **Yahoo!** turned over data. But on Jan. 24 enthusiasm was dimmer as Google agreed to censor search results in **China**. The move comes as Google launches a China-based site. See **founder Sergey Brin** to **Maria Bartiromo** at Davos: "It's best to get as much as we can for now and move the ball forward."

See "Google's dicey dance in China," www.businessweek.com/go/tbw

Bidding Wars End And the winners are... **Boston** **tific** and **Arcelor**. Ending months of brinkmanship, **son & Johnson** ceded medical-implant maker **Guidant** to **chrival**, **Boston Scientific**, for \$27 billion on Jan. 25, days after Germany's **ThyssenKrupp** declined to bid more than \$4.9 billion for Canadian steelmaker **Dofasco**. The losers might end up winners for having resisted temptation to overpay. Plus, J&J gets a \$705 million cup fee from Guidant.

"What's J&J's next target?" www.businessweek.com/go/tbw

ing Westinghouse You don't need a geiger counter to tell nuclear reactors are hot—just look at the global demand for **Westinghouse Electric**. On Jan. 23 parent **British Nuclear Fuels** chose a \$5 billion bid from **Toshiba** over offers from **Matsushita**, **Hitachi**, and **GE**. Toshiba covets Westinghouse's expertise in pressurized water reactors, now in demand in China. Beijing plans to spend \$50 billion building roughly 30 new reactors over 14 years.

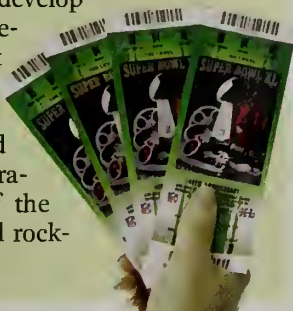
See "China: A bull in the energy shop," www.businessweek.com/go/tbw

Saudi-China Deal How do you feed a hungry dragon that starts with oil. That's what **Saudi King Abdullah** and **Chinese President Hu Jintao** talked about in Beijing on Jan. 23. The leaders signed a pact that would boost Chinese investment in Saudi crude, gas, and refineries. Nice bennies for both sides: The Saudis get a reliable customer, China gets the supplies to power its booming economy—and Washington gets left out in the cold.

See "China: A bull in the energy shop," www.businessweek.com/go/tbw

Regulation of the Week

Enoosing and **Wall Street** go together like palms and desert. Firms have long lavished goodies on clients—from the egregious (and illegal) bestowing of shares in initial public offerings to front-row seats at the Metropolitan Opera—although gifts are not supposed to carry the pro quo that the client steer his business to the giver. Now, under rules proposed on Jan. 23, the **New York Stock Exchange** and **NASDAQ** will require firms to justify perks they dole out. Each firm must develop written policies to define what entertainment is "appropriate" and inappropriate and to detect and prevent entertainment that is intended as an inducement for obtaining customer business, or could give rise to a conflict of interest. The regs urge firms to develop specific dollar limits or to require supervisory approval at certain thresholds. While the austerity may lie ahead, Wall Street denizens had hoped for something a tad more dramatic, especially in light of the **Abramoff** lobbying scandal rocking Washington.



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EXECUTIVE SUITE

INSIDE THE COUP AT NIKE

Founder Phil Knight is a case study of the charismatic leader who can't let go. Ex-CEO William Perez, his latest casualty, learned that the hard way

BY STANLEY HOLMES

FROM THE TIME NIKE founder and Chairman Philip H. Knight anointed William D. Perez as his successor in November, 2004, the two men had a regularly scheduled meeting on Monday mornings at 9. The get-togethers had been Knight's idea. They gave CEO Perez, a surprise choice who had previously held the top post at S.C. Johnson & Son Inc., the manufacturer of Glade air fresheners and Drano, an informal forum for bouncing ideas off the legendary figure who all but personified the company.

When Knight took a seat at the round conference table in Perez' office on Jan. 9, it seemed like any other mundane Monday meeting. The discussion methodically progressed through several unremarkable issues, Perez says. But Knight was saving a bombshell for last. Abruptly declaring that

Perez had failed to mesh with the rest of the Nike team, Knight told him it was time to go. Perez was stunned. "He caught me off guard," he said in an extensive interview with *BusinessWeek*. Knight declined to comment on the details of Perez's account. "I and the Board decided that the company could be better managed with a proven, seasoned industry veteran," he said.

BAD CHAPTER

PEREZ SAYS HE ASKED Knight for a few days to absorb the news and prepare his family for upheaval. He also asked the board for an opportunity to appeal the decision and was granted a 15-minute audience on Jan. 18. But on Jan. 20 the board sided with the company's largest shareholder and approved Knight's recommendation to name Nike veteran and co-President Mark Parker as chief executive. "He will become the best CEO this company

has ever had," Knight crowed in a January conference call.

No amount of corporate spin can conceal one of the worst chapters in the history of Nike Inc. It marks the third time the mercurial Knight, 67, has tried to oust himself from his throne. Nike's leader and board members have long acknowledged the company's top strategic priority was managing succession. But despite the company's hip image and record performance this year, it's hard to imagine they'll have much luck enticing outside candidates to consider joining the company in the near future. "It's a little like a death wish coming into that company from outside," says Stephen Joseph, president of the Directors' Workshop Inc., which runs workshop seminars for board members.

That perception could become self-fulfilling because Knight and the

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“From virtually the day I arrived, Phil was as engaged in the company as he ever was. He was talking to my direct reports. It was confusing for the people and frustrating for me.”

—William Perez,
outside his vacation home
in Naples, Fla., the day after
his ouster as CEO of Nike



when they hired Perez, acknowledged the insular company's need for fresh blood. Knight also recognized Nike's reputation as a difficult place for transplants to thrive and promised to go out of his way to make Perez feel at home. "There will be a little bit of a bumpy period," Knight told *BusinessWeek* a month after he hired Perez, but "I'm committed to making it work."

The fact that Perez failed, despite Knight's stated intentions, underscores how hard it is for new CEOs to fill the shoes of charismatic corporate founders whose personality and ego are closely tied to their companies. History is full of examples of legendary leaders who, because of their own shortcomings or problems with their successors (below), had trouble handing over the reins. In Perez' view, Knight's name belongs near the top of this list. "From virtually the day I arrived, Phil was as engaged in the company as he ever was," Perez said. "He was talking to my direct reports. It was confusing for the people and frustrating for me."

DEFT JUGGLER

THE WOUNDS are still raw for the man who just got dumped from one of the most glamorous jobs in American business. He retreated to his second home in Naples, Fla., immediately after the dismissal. "It's been very tough on my family," said Perez, 58, noting that his wife had left a job she loved as a high school Spanish teacher in Racine, Wis., when he took the Nike post. He added that Knight "piled it on in the media" after the news was announced.

So why did Knight even hire Perez? Be-

Perez vs. Knight: The Issue That Drove Them Apart

In the 13 months since William Perez was tapped as founder Phil Knight's successor, basic differences in their approach to the business became clear—and led to Perez' ouster

STRATEGY

PEREZ: Proposed increasing direct sales to consumers through Web and Nike stores

KNIGHT: Favored current practice of selling through third-party retailers

AUTONOMY

PEREZ: Thought he would have free rein to make over the company

KNIGHT: Continued to give strong input on even seemingly minor issues

COSTS

PEREZ: Wanted to take an ax to Nike's lavish operating expenses

KNIGHT: Supported the goal but differed with Perez on how to achieve it

CULTURE

PEREZ: Believed that Nike was too resistant to outside ideas

KNIGHT: Did not think Perez understood creative mind

cause he wanted someone with strong financial and managerial discipline and a track record overseeing the growth of a profitable consumer-products company. In running S.C. Johnson, Perez had deftly juggled the managing of multiple brands in multiple countries. Knight and the board took more than a year searching for the right candidate. After reading 75 résumés, conducting 15 interviews, and meeting extensively with three or four final candidates, Knight picked Perez, a self-described introvert with a quiet, analytic bearing.

Hoping to give his successor sufficient time to understand Nike's \$11 billion global sneaker and apparel business, Knight put nothing on Perez' plate during the first six months. His sole job was to

travel, listen to employees, and meet business partners. The honeymoon ended, says Perez, as soon as he began to assert his leadership. He triggered a widespread staff revolt, one that he was unable to overcome, with his first big move hiring Boston Consulting Group to help him conduct a sweeping review of the company's strategies and practices.

The study required managers to spend two hours responding to a detailed survey. "Perez started asking questions of 20-to-30-year veterans that have never been asked before," says one Nike manager. "Surveys are not Nike's specialty; it's not Nike's culture."

The consultants had two goals: figure out how to control the double-digit rise

GOVERNANCE

A Short History Of Unpassed Torches

There was an eerie sense of déjà vu about the management shakeup at Nike Inc. this week. Not only has the edgy shoemaker failed at earlier attempts to pass the baton, but business history is littered with the troubled successions of charismatic entrepreneurs and once and future kings. For visionary founders, the years of emotional investment, the inextricable melding of their own identity with the business, and the

distancing from their creation can all pile up to create a transition that has classic corporate melodrama written all over it. "It's like Shakespeare or Greek tragedy or the Bible," says Jeffrey A. Sonnenfeld, senior associate dean at the Yale School of Management. "It's just such a predictable script."

One of the most famous such scripts stars William S. Paley, founder of Columbia Broadcasting System. Over the span of his



ELLISON His second in command jumped ship

60-year reign at the company, he made at least four attempts to establish a successor failed. Indeed, his final return to power, at age 85, was even more dramatic than the recent maneuverings of Nike's 67-year-old Phil Knight. In Silicon Valley, Lawrence J. Ellison, the autocratic software king of Oracle Corp., talks little about succession, a concern on Wall Street—at

has resisted passing the torch to potential heirs apparent such as Ray Lane, who later left the company. Ellison shook up his top ranks two years ago, making his CFO chairman and appointing two people as co-presidents.

While Return of the Founder is a familiar drama, there are many variations on the

KNIGHT IN CHARGE Knight claims new CEO is Mr. Right

ing expenses and examining
 er Nike had the right growth strategy
 ce. Almost all of their ultimate rec-
 endations hit longtime staffers, quite
 of whom came from rival firms
 nsey & Co. and Bain & Co., like
 shells. Boston Consulting proposed
 ing sales by, among other things,
 ng outlet stores—a move that the im-
 bessed Nike team feared would de-
 the value of the brand. The firm
 ed to cut costs by outsourcing day
 anitorial, and security services. “The
 was to raise awareness in the com-
 o control operating expenses,” Perez
 “I was trying to accelerate the pace,
 ost of my resistance came from Phil.”
 Knight and Perez also clashed over a

me. Charles R. Schwab recently took back
 CEO title at the company he built. Ted
 tt, the ponytailed entrepreneur who built
 maker Gateway Inc., pushed out his
 ndpicked replacement and much of the
 or management team, renaming himself
 D. (He has since left the company.) And
 n, famously, there is Steve Jobs (page 62),
 o represents the rare case where a strong
 nder is ousted by his own recruit, former
 le Computer Inc. CEO John Sculley
 ough Jobs bounced back triumphantly).
 Knight’s story adds a new chapter. “The
 e challenge of corporate governance is
 ing past the concept of the imperial
 O,” says Ric Marshall, chief analyst at The
 orporate Library, a research firm
 icalizing in governance issues. “Nobody
 mplifies that better than Phil Knight.”
 eed, the failure of the Nike succession
 n, say Marshall and other governance

highly charged political battle between the
 company and the city of Beaverton, Ore.,
 which was trying to annex the Nike cam-
 pus against the company’s wishes. This
 summer, a friendly state legislature
 stopped the city from its annexation claim
 and gave Nike its independence for another
 35 years before the issue would be re-
 viewed again. “I thought that was fine,”
 Perez says. “But not Phil. He wanted to sue
 Beaverton. I thought that was a bad idea
 because it would have created ill will with
 the public and with the lawmakers that
 had helped us out.” But what rankled
 Perez even more was the larger question:
 Why was Knight even devoting any time to
 such a minor issue?

Perez, who came from a consumer-

experts, rests squarely on the board’s
 shoulders. With Nike, in Sonnenfeld’s
 opinion, “you have a board that was on
 cruise control.... [They were] a complete
 rubber stamp.”

While the conventional wisdom advises a
 clean break from CEOs, and especially
 strong founders, in
 practice there are
 sometimes advantages
 to having them stick
 around. Starbucks
 Corp.’s Howard D.
 Schultz or Microsoft
 Corp.’s Bill Gates, for
 instance, are visionary
 entrepreneurs whose
 continued presence is
 clearly an asset. “No one
 in their right mind would
 want Bill Gates or



PALEY He came back
 four times, the last at 85

product marketing background, says he
 sometimes wondered if Nike’s famously
 creative, irreverent advertising was actu-
 ally conveying relevant messages about
 the product. The first commercial he saw
 was a 30-second spot aimed at last year’s
 NCAA basketball tournament. The com-
 mercial showed ants crawling onto the
 basketball court. After 28 seconds, a
 voice would say “Nike basketball.” His
 concern: The ad explained nothing about
 the product, and it had minimal brand
 presence. “I came from a rational world
 of communications,” Perez said.

Nike insiders, meanwhile, were devel-
 oping a parallel set of concerns about
 Perez. “He didn’t have an intuitive sense
 of Nike as a brand,” said one of them.
 “He relied more on the spreadsheet, ana-
 lytical approach as opposed to having a
 good creative marketing sense.”

In the end, Knight said that he could
 tolerate only so much friction. “I think the
 failure to really kind of get his arms
 around this company and this industry
 led to confusion on behalf of the manage-
 ment team,” he said at the Jan. 23 press
 conference. In a later interview with
BusinessWeek, Knight claimed to have
 learned from the misadventure. “Com-
 munication is huge, and I didn’t know
 that would be as big of an issue with Bill,”
 Knight said. “There is no question com-
 munication between Mark Parker and me
 will be better than between me and Bill.”
 That’s probably true. It’s hard to see how
 the dialogue between Knight and Perez
 could have been much worse. ■

—With Jena McGregor in New York

Michael Dell to run off to take scuba diving
 lessons,” says Sonnenfeld.

If a charismatic leader is to remain on the
 premises after a replacement arrives,
 boards must draw clear lines of
 demarcation to allow the newcomer to do
 his or her job. Sonnenfeld also suggests the

board take a role in making sure
 the founder finds an engaging
 way to do something new.

Most of all, boards can’t be on
 the hunt for the founder’s better
 twin. “The message about filling
 shoes is that you can’t,” says
 Stephen P. Mader, vice-chairman
 at executive search firm
 Christian & Timbers. “You’ve got
 to design new shoes.” Luckily,
 Nike already has that skill. It just
 has to learn new ways to apply it.

—By Jena McGregor

(TOP TO BOTTOM) GREG SAHL-STEPHENS/AP/WIDE WORLD; CARL MYDANS/TIME LIFE PICTURES/GETTY IMAGES

MEDIA PLAYERS

THE BUG IN MICROSOFT'S EAR

It's mulling its own digital device that adds gaming to music and video

BY JAY GREENE

AFTER GETTING trounced for four years in the digital music business by Apple Computer Inc., Microsoft Corp. finally seems poised to do something about it. *BusinessWeek* has learned that the software giant is working on plans to develop its own portable digital media device to rival the iPod rather than just providing technology to partners. Microsoft hasn't decided if it will

GATES Playing with an Xbox at the Consumer Electronics Show in Las Vegas

go ahead. But sources inside the company and at its partners say Microsoft has put together a team that's considering the business end of such an initiative.

Going forward with it would be an acknowledgement that the current strategy isn't working. Chairman William H. Gates III has argued that consumers would prefer a vast choice of devices to the limited selection from Apple. That's why Microsoft has relied on dozens of partners to come up with sleek devices and clever online-music services that use its software. But each year, Apple extends its lead in digital music. In 2005, Apple's share of portable media devices sold in the U.S. grew to 67% from 52% in 2004, according to NPD Group Inc. Making its

own device, despite an uneven track record in consumer electronics, may be Microsoft's only viable alternative.

What would it look like? Xbox boss Peter Moore says any Microsoft media device would have to leverage the company's most significant consumer strength: video gaming. "It can't just be our version of the iPod," says Moore, who nonetheless would not confirm that Microsoft is considering making such a device. Such a device would include game software. Microsoft would probably use the Xbox brand to market the gadget. "I think the Xbox brand is an opportunity," Moore says.

True, perhaps, but also risky. If the device comes with the Xbox brand, many consumers will view it as a game player like Sony Corp.'s PlayStation Portable. That might limit its appeal since the portable gaming market is much smaller than the one for digital media.

TARGETING THE LIVING ROOM

THERE'S ALSO THE RISK of alienating partners. If Microsoft fashions its gadget, those device makers could abandon Microsoft's digital media technology and devise their own software. "Everyone will try to do their own thing to differentiate," says Sim Wong Hoo, chief executive of Creative Technology Ltd., the No. 2 digital media device maker. "What Microsoft was trying to build will collapse."

With \$39.8 billion in annual sales, Microsoft isn't particularly interested in increments from the digital media device business or online music. It's after a share in consumers' living rooms. The company's consumers purchase iPods, the Xbox, and they'll buy songs and videos from iTunes and the various iPod accessories to use music and video around their house. Microsoft in turn convinces more entertainment companies to partner with Apple. "The stakes are incredibly high," says Michael Gartenberg, vice-president and research director at JupiterResearch.

The question still remains: Will Microsoft really do it? It has abandoned efforts over the years to make every part of its business work. The company gave up on computer speakers to PC-connected telephones. The company gave up on its media software unit and its MSN Internet service under Robert J. Bach, president of the Entertainment & Devices Division. It's a lot easier to talk about the end-to-end scenarios because it's all under Robert J. Bach. Says Microsoft's Moore. Indeed, the soup-to-nuts approach has been the key to Apple's success. For Microsoft, it's worth the risk. ■

An XPod?

Microsoft could launch an iPod killer of its own

WHY DO IT? Microsoft Windows Media technology has little traction in the portable-music market. Microsoft might try to change that by building its own player rather than relying on partners.

HOW WILL IT BE DIFFERENT? The one thing the iPod can't do (yet) is play sophisticated video games. A Microsoft music player would harness the company's Xbox technology and brand.

WHAT ARE THE HURDLES? The Xbox aside, Microsoft has a spotty track record in consumer products. Apple has a huge lead. And Microsoft could alienate its hardware partners.



DETROIT

CHRYSLER SLIPS OUT OF CRUISE CONTROL

Challenges are up. Sales are slowing. Can new models keep the turnaround going?

BY DAVID WELCH AND DAVID KILEY

IS CHRYSLER GROUP'S TWO-YEAR-old turnaround in need of a jump-start? With all the focus on serially troubled General Motors Corp. and Ford Motor Co., it's easy to overlook the fact that Chrysler is experiencing some of the same mechanical difficulties as its Motown rivals.

For now, the auto maker remains far behind GM. After all, it took six years to cut its costs four years ago and had some big successes, including the new 300 sedan and a line of minivans with cool foldaway seats.

Starting last summer, amid a raging price war between Ford and GM, Chrysler itself was forced to discount heavily, says researcher Edmunds.com. The auto maker denies it, but cars have been piling up on dealer lots. As a result, Chrysler will have to sell fewer vehicles this year and forfeit profits. "A lot of people haven't looked closely enough" at Chrysler, says AutoPacific analyst James N. Hall. "They have a lot of challenges."

Chief among them will be coming up with another hit like the 300 sedan,

which generated plenty of buzz and brought home an estimated one-fifth of the company's \$1.7 billion in operating profit last year. To keep Chrysler from slipping into one of its patented swoons, which typically have followed a Phoenix-like rise, newly minted CEO Thomas LaSorda wants to duplicate the 300 strategy.

The 300 is a rare example of how Detroit has successfully mimicked the Japanese scheme of building several distinct vehicles on one platform at the same factory. The beauty of the concept, especially for a carmaker staging a comeback, is that if one of the vehicles is a hit, the success can provide cover for less popular siblings, while the factory operates profitably.

That's what happened with the 300. The sedan makes gobs of money. So its stablemates, the slow-selling Magnum station wagon and new Charger muscle car, need not be triumphs. The 300, says LaSorda,

MONEY MACHINE

It won't be easy to turn out another hit like the 300 sedan

"has had a huge impact" on the profitability of the whole platform lineup.

Chrysler's first attempt to stage an encore comes this spring, when the carmaker will begin to replace its Neon compact, a pokey seller, with three models aimed at narrow segments of the marketplace. First to arrive will be the Dodge Caliber, a hatchback whose athletic stance and sharp styling have earned critical plaudits. It will be followed in the fall by the Compass crossover, the first Jeep to be built on a car chassis, and later by the Patriot, a compact SUV that fits the traditional Jeep mold.

It's a bold play. Replacing one model with three is more expensive going in. And while predicting hits in the car biz is dicey, neither the Caliber nor the Compass is quite as eye-catching as the 300. Besides, both could have trouble luring buyers for other reasons. Americans have never really fallen for hatchbacks, and a car-based Jeep may not mesh with the brand's rugged image.

TRUST PROBLEM

CHRYSLER IS also taking another crack at the brutally competitive family sedan market. At the end of the year the carmaker will replace its Sebring and Dodge Stratus also-rans with a pair of cars developed with Mitsubishi. Even if they are knockouts—a tall order—the hard truth is that most buyers simply don't think of Chrysler when they consider trading in that Camry or Accord. According to a survey conducted last year by research firm Strategic Visions Inc., fewer than 20% of respondents associate Chrysler and Dodge brands with trust, compared with 43% for Toyota Motor Corp. and 35% for Honda Motor Co.

Meanwhile inventory is growing.

Chrysler takes an average of 82 days to sell its cars, about 20 days longer than the industry average, according to J.D. Power. "My dealerships have more cars than they've ever had," says Sidney B. DeBoer, chairman and CEO of Lithia Motors Inc., which owns 35 Chrysler dealerships. He and LaSorda are both pinning their hopes on the same thing: another 300-style hit to give this faltering rebound a jolt of octane. ■

—With Gail Edmondson in Frankfurt

THE STAT

\$1.2 Billion

Projected operating profit for Chrysler Group this fiscal year, down from an estimated \$1.7 billion in 2005

Data: Société Générale

CEO PAY

NOT YOUR ORDINARY GOLD WATCH

Hank McKinnell's pension haul is making him a poster boy for executive excess

BY AMY BORRUS

TO MANY SHAREHOLDER advocates, Pfizer Co. and Henry A. McKinnell Jr., its chairman and CEO, are model corporate citizens. On McKinnell's watch, Pfizer ditched poison pills and other takeover defenses and decreed that a director who fails to win a majority of shareholder votes must offer to resign. It provides detailed disclosure of executive perks and is one of few companies that base stock bonuses on five-year performance, not short-term targets. Pfizer "is not one of the bad guys," says pay analyst Paul Hodgson of The Corporate Library, a governance research firm.

That won't count for much in the 2006 proxy season. Labor and public pension funds are making McKinnell a poster boy for extravagant pay. Unions and other shareholder groups will blast boardrooms with pay proposals this year, hoping to lend heft to the Securities & Exchange Commission's push to unmask executive pay, perks, and pension benefits. And McKinnell will be Exhibit A, thanks to pay studies that say he has the fattest retirement package among sitting CEOs of companies in the Standard & Poor's 500-stock index (table). Both The Corporate Library and Harvard Law School professor Lucian A. Bebchuk estimate that McKinnell, who is to retire in 2008, will get \$6.5 million a year for life. Bebchuk's paper pegs McKinnell's total pension payout at more than \$71 million.

Contrast that with McKinnell's 2005 salary of \$2.3 million and Pfizer's recent sluggish performance, and some labor activists see a problem. "The goal of pension benefits is to provide for a secure retirement; it's not supposed to be a wealth-creation vehicle," says Brandon Rees, research analyst in the AFL-CIO's office of

investment. The labor federation wants to require New York-based Pfizer to get shareholder approval for any senior executive pension benefits that exceed the officer's final average salary.

McKinnell's pension package was pumped up in part by \$5.8 million in performance-based shares. The awards, which vested in 2004, had been granted

before he became CEO in 2001. Pfizer's those stock plans "were approved overwhelmingly by shareholders and were in place during a period of tremendous success for the company between 1993 and 2004." In 2000, McKinnell and the board saw how stock awards could balloon retirement pay and decided not to count future grants in the pension formula. Earlier grants, including McKinnell's, were left in.

Now, Pfizer's board has agreed to get shareholder approval before letting executives collect pension benefits that exceed 100% of their salary and bonus. Many companies have separate retirement plans for executives that typically pay 60% of salary and cash bonus.

The AFL-CIO says executives should collect more in pension than in salary. And it zings Pfizer's board for not retiring McKinnell's stock awards from pension or asking him to give up some retirement pay. The company says that would be unethical and possibly illegal. The AFL-CIO counters that workers often give up promised benefits, too.

Labor has other issues with Pfizer. The company was a member of a coalition that backed President George W. Bush's last year to create private accounts for Social Security. "It's ironic that a CEO with the largest guaranteed pension is advocating conversion to a risky Social Security privatization plan," says F.

But other big investors are restless, too. Pfizer's stock is down 46% since McKinnell became CEO five years ago, compared with the 27% slide in the Amex drug index. That has led Connecticut surer Denise L. Nadeau, who oversees the Connecticut Retirement Plans Trust Funds, to question the \$4 million cash bonus McKinnell got last year. "Is this really pay for performance?" she asks. "He may be making the right moves. But it could have a hard time convincing shareholders that McKinnell's \$7 million payout is right."

—With Amy L. in Philad



SUNSET YEARS
McKinnell's pension will dwarf his salary

Notable Nest Eggs

Top annual pension payouts among S&P 500 CEOs

CEO	COMPANY	ANNUAL PENSION BENEFIT* (MILLIONS)
Henry McKinnell	Pfizer	\$6.5
Lee Raymond**	ExxonMobil	6.5
Edward Whitacre	SBC Communications†	5.5
William McGuire	United Health Group	5.1
Samuel Palmisano	IBM	3.8
Reuben Mark	Colgate-Palmolive	3.2

*As of the end of 2004 **Retired at the start of 2006 †Now AT&T
Data: The Corporate Library LLC

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INVESTIGATIONS

MORE HEAT ON HEDGE FUNDS

Regulators are probing trades by managers with inside access

BY EMILY THORNTON

AS IF THERE WEREN'T enough controversy surrounding hedge funds, now the Securities & Exchange Commission is investigating suspicions that fund employees are engaging in insider trading.

It's not the typical heard-it-from-a-friend-at-the-company stuff, either. In the last decade hedge funds have ventured into the deepest reaches of finance. They've gone from trading stocks and bonds to making loans, participating in private placements, sitting on bankruptcy committees, and agitating for positions on corporate boards. In the process they've obtained all sorts of nonpublic information—and regulators are worried that many have been mismanaging it at best and illegally profiting from it at worst.

The SEC, NASD, and Financial Services Authority in London have launched a flurry of probes. So far the inquiries have resulted in only a handful of insider-trading charges against hedge fund managers. But regulators expect the improper handling of insider information to be a big focus of enforcement actions in 2006. "Hedge fund assets have grown significantly, and there is a lot more competition for returns," says Scott W. Friestad, an associate director at the SEC's Enforcement Div. "In this situation people sometimes

cut corners. We are devoting substantial resources to these investigations." Steve Luparello, an executive vice-president for market regulation at NASD, agrees. "Hedge funds misusing nonpublic information is a growing issue," he says.

Perhaps the easiest avenue of abuse: private placements, or restricted shares of public companies that are sold directly to investors. Regulators are cracking down on funds that participate in private placements and then take advantage of the information they glean. The biggest case thus far has been that of Hillary L. Shane, the manager of hedge fund FNY Millennium Partners LP. The NASD and SEC charged her in May with fraud and insider trading for allegedly agreeing to buy unregistered

"We are devoting substantial resources to these [inquiries]," says the SEC

shares as part of a private placement in Maryland security systems outfit CompuDyne Corp. and then short-selling the registered stock, betting that it would fall in value.

Investment bank Friedman, Billings, Ramsey & Group Inc. invited Shane to participate in the placement on the condition that she treat the information as confidential. Shane

paid a \$1.45 million fine to settle charges brought by the SEC and the NASD. She never admitted or denied wrongdoing. Shane's lawyer declined to comment.

Compromising Positions

As hedge funds permeate every corner of finance, they're facing allegations of misusing insider information by:

- Trading on information provided by investment banks for upcoming private placements and other securities
- Trading on information obtained when a hedge fund makes a loan to a company
- Allowing porous Chinese walls with their trading rooms while they serve on bankrupt companies' creditors' committees



TIP OF THE ICEBERG

THERE'S LIKELY TO BE much more out from the CompuDyne case. NASD says it's still investigating individuals and entities. Regulators haven't accepted FBR's offer to pay \$7.5 million to settle charges that it aided the hedge fund manager. FBR declined to comment.

Meanwhile, an investigation into D. Greenfield, the 60-year-old prince of New York-based broker-dealer River Capital LLC, has brought the issue of mishandling of nonpublic information obtained from bankrupt companies' creditor committees to the forefront. In November, Greenfield paid the \$150,000 to settle charges that he failed to guard sufficiently against the poten-

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for misuse of insider information he obtained while serving on the bankruptcy committees of WorldCom, Adelphia Communications, and Globalstar Telecommunications.

Greenfield had agreed to keep all information confidential and informed his employees that he couldn't trade in the securities of those issuers. But the Chinese wall separating him from his traders was porous. Greenfield frequently walked through his firm's trading room—which consisted of four

desks on the ground floor of his New York City townhouse—and asked employees for stock quotes for Adelphia and WorldCom securities, according to the SEC complaint. Greenfield did

One fund manager paid \$1.45 million to settle with regulators

not admit or deny the charges. And “there was no finding of any misuse of material nonpublic information,” says Greenfield's attorney, Arthur S. Linker of Katten Muchin Rosenman LLP. “There was no finding of insider trading.”

Nevertheless, the settlement has spurred other industry veterans to lodge complaints of possible insider trading by hedge funds and other creditor committee members. “We have heard that there's more insider trading and misrepresentation to get on creditors' committees than had been reported to us,” says Alistaire Bambach, chief bankruptcy counsel in the SEC's Enforcement Div. “We are very concerned about these activities.”

In London, the Financial Services Authority is investigating abuse of confidential borrower information. The case everyone is talking about: a probe into whether a trader at GLG Partners LP, a London hedge fund, improperly used information provided by Goldman, Sachs & Co. in advance of a security offering by Sumitomo Mitsui Financial Group Inc. in 2003. “The FSA is concerned about any instances where parties who are made insiders then use that information to trade in related securities,” says spokesman David Cliffe. The crackdown is just beginning. ■

—With Amy Borrus in Washington and Stanley Reed in London

MARKETING

GILLETTE'S NEW EDGE

P&G is helping pump up the Fusion razor

BY WILLIAM C. SYMONDS

PROCTER & GAMBLE CO. didn't advertise in the Super Bowl in 2005. But after acquiring Gillette last fall, it's going long on the glitzy gridiron: two ads for its new Fusion five-blade razor at a cost of more than \$6 million.

The ad, competing against Budweiser's Clydesdales and Careerbuilder.com's office monkeys for post-game buzz, begins with a helicopter screaming across the Mojave Desert to a lab where two scientists disembark, insert canisters into consoles, and set off “the miracle of fusion.” The image couldn't be more fitting for two companies trying to showcase how melding their strengths

was worth the \$57 billion P&G paid for the king of blades.

Executives from both sides say Gillette developed Fusion on its own. Its team led the marketing launch, too, right down to casting the scientists instead of using Gillette's high-priced pitchman, soccer star David Beckham.

But make no mistake: P&G's clout kicks in once Fusion hits stores on Jan. 27. Gillette is blanketing stores with 180,000 displays in the first week, coverage it took a year to achieve with the Mach3 razor in 1999. Later, P&G will take Fusion into Canada and Eastern Europe, where Gillette is weak. “You'll see Fusion absolutely everywhere you go,” predicts Peter Hoffman, president of global grooming who is heading the campaign.

LAWNMOWER EFFECT

ACHIEVING DOUBLE-DIGIT revenue growth in the razor business, where Gillette has a 72% market share, is no main attraction, but P&G hopes to do more. Gillette has been second banana in the U.S. shaving cream market and in the growing men's grooming market. To reverse that, P&G has folded shave-prep products group into its beauty-care unit and made it “an extremely high priority,” says P&G CFO Clayton Daley Jr. And for the first time, Gillette is rolling out grooming products with a new razor under the same brand, including Fusion HydraGel shaving gel.

Comics no doubt will have a field day with Fusion, mocking the lawnmower effect of five blades. But consider this: Fusion, including an \$11.99 battery-operated version, will command 30% higher prices than Mach3 products.

At the time when P&G can't raise prices on Tide or Clorox, Morgan Stanley predicts Fusion will take 15% of U.S. market this year, boosting P&G's earnings by \$100 million. That's what was betting on when he bought Gillette. Now Hoffman has to do the math—deliver—and justify the P&G in the big game.

—with Robert E. Hoffman in Chicago

Looking Sharp

How the clout of new parent P&G could help the Fusion launch:

1 RETAIL HEFT Gillette is piggybacking on P&G's much bigger retail presence to ship 180,000 displays before the Super Bowl—a level Mach3 didn't reach for a year

2 INTERNATIONAL Once Fusion goes global, P&G's superior distribution will help speed its adoption in markets such as China and Eastern Europe

3 GROOMING P&G's marketing expertise should help bolster Gillette's lagging shaving-prep business



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CHINA

TO GET RICH IS GLORIOUS

More Chinese are becoming millionaires—and driving a fast-growing market for luxury goods

BY DEXTER ROBERTS AND
FREDERIK BALFOUR

WANG ZHONGJUN is loaded and happy to flaunt it. He wears Prada shoes, Versace jackets, and a Piaget watch. He smokes Cohiba cigars from Cuba. He drives a white Mercedes-Benz SL600, a silver BMW Z8, and a red Ferrari 360. His art collection includes hundreds of sculptures and paintings. Value: \$30 million or so. Home sweet home is a 22,000 square-foot mansion north of Beijing with antique British and French furniture, a billiard room with bar, and an indoor pool. When he tires of swimming, Wang can head to his stable (annual upkeep: \$500,000) of 60 horses from Ireland, France, and Kentucky. "Entrepreneurs in China today feel much safer than before," says Wang, a 45-year-old movie producer who served in the Chinese army, studied in the U.S., and learned painting before backing internationally acclaimed films such as *Kung Fu Hustle*.

WHEELER DEALER
Beijing's Rolls
outlet is a top
performer

"We are more accepted by the media, government, and society today."

That's for sure. Even though Deng Xiaoping declared that getting rich is glorious nearly three decades ago, just a few years back China's millionaires were running scared. When a *Forbes Magazine* survey of China's richest appeared in 1999, wags called it the "death list" after a tax crackdown targeted many who made the cut and landed some in jail.

Now China is embracing them. More than 300,000 Chinese have a net worth over \$1 million, excluding property, according to Merrill Lynch & Co. And main-

land millionaires control some \$530 billion in assets, Boston Consulting Group estimates. "There has been a revolution in attitudes toward wealth," says Rupert Hoogewerf, who authored the 1999 list. He now runs Hurun Report, a Shanghai-based company specializing in information about China's rich, which just released a survey on millionaires' buying habits. "People don't appreciate how much cash there is running around in China today," he says.

"DIZZY" OVER SHOES

MANY PEOPLE MIGHT not appreciate it, but luxury retailers sure do. Just five years ago mainland buyers accounted for 1% of global sales of luxury handbags, shoes, jewelry, perfume, and the like. Today the Chinese are the third-biggest high-end buyers on earth, with more than 12% of

world sales, Goldman, Sachs & Co. reckons. Within a decade, China will leapfrog Japan and the U.S. to become top luxury market, predicts Goldman analyst Jacques-Franck Dossin. "China is experiencing huge wealth creation, there is lots of conspicuous consumption related to that," Dossin says. "People want to show they are successful."

How? By buying custom clothes, diamond-encrusted watches, pricey gourmet meals, and fine wine. Zhao Hui, a chain-smoking 38-year-old restaurant real estate developer, and Ferrari owner from Shanghai, says he speaks no English but he manages to pronounce "shopping" and "Tiffany" as he shows off his \$50,000 Franck Muller watch. Richard Hung, a 40-year-old manager of a pharmaceutical company, has a closet filled with dozens of Armani, Gucci, and Canali suits and

more than 100 pairs of Italian shoes. "I get dizzy when I look at those shoes," he says. Where to buy them? Try Beijing's exclusive Chang An Club, where members can blink at the \$18,000 initiation fee. "Our members can afford it," says General Manager Cees van Gevelt, adding that Chang An aims to keep its prices higher than rival gatherings. The rich "want to join the most expensive club in China," he says.

Luxury marketers are happy to serve up plenty of flash and bling to keep sales rolling. Vuitton, which has a dozer of boutiques across the mainland, last November served up 1,500 bottles of Veuve Clicquot and tasters of *pâté de foie gras* at a celebrity-packed launch in Beijing. And fashionistas still marvel at Miucci-



THE STAT

300,000
Millionaires in China*

*People with more than \$1 million in liquid assets (excluding real estate)

Data: Merrill Lynch

CONSPICUOUS

Wang in his 22,000 square-foot home

"skirt show" last spring, when she
over seven stories of Shanghai's art
Peace Hotel.

CADILLAC CAFE

KEY WHEELS do pretty well, too. The
s-Royce outlet in Beijing is one of the
d's top-selling dealerships. And
ley Beijing has sold a half-dozen 728
ch limos—at \$1.2 million each, the
d's most expensive car—more than
other dealership in the world. For
tier millionaires without an extra mil-
to drop on transportation, Cadillac,
cedes, or BMW are eager to help.
oppers at any of a dozen "Cadillac Ex-
cense Centers" in the mainland, for in-
ce, can relax on a black leather sofa
enjoy a glass of Rosemount Cabernet
ne "Cadillac Cafe" while browsing
ugh photo-rich brochures that de-
cribe the brand's 102-year history. "Our
le showroom supports our brand: It's
ern, sophisticated, and not your tra-
tional luxury vehicle," says Stuart J.
ice, who oversees the Cadillac brand at
Shanghai General Motors Co.

ow the luxury goods marketers are
going far beyond Beijing and Shanghai
and China's millionaires. Cadillac plans

to have 40 showrooms in China
by the end of 2007, and last year
dispatched a 1959 El Dorado
convertible on a seven-city "her-
itage tour" to drum up interest
nationwide. At this month's ice
festival in the frigid northern
city of Harbin, watchmaker
Cartier has created a massive ice
replica of its flagship Paris store.
"Our aim is to have the second-
and third-tier cities become a
more important part of our
business," says Daniel Chang, who over-
sees Cartier's sales in northern China.

Lately China's new moneyed class has
gotten interested in more than fast cars,
flashy threads, and extravagant time-
pieces. Growing numbers of mainlan-
ders are snapping up everything from
ancient scrolls and traditional ink paint-
ings to French Impressionists. Christie's
International says mainland buyers ac-
count for 20% of purchases at its Hong
Kong auctions, compared with virtually
none five years ago. And while most col-
lectors prefer Chinese art, mainlanders
now bid on Renoirs, Monets, and Van
Goghs in New York and London, and a
Shanghai businessman paid \$1 million

Suddenly, China is the No. 3 consumer of high- end goods

for a Picasso in a private sale.
"There's tremendous poten-
tial," says Ken Yeh, deputy
chairman of Christie's Asia.

Even as the likes of Cartier,
Christie's, and Cadillac try to
separate China's millionaires
from their wealth, others aim
to help them preserve it. Al-
though foreign banks are
barred from marketing their
offshore services inside China,
they are discretely wooing

mainland clients via their Hong Kong of-
fices, figuring those who have made mon-
ey abroad are fair game. And soon, bank-
ing regulations in the mainland are to be
relaxed. "In the long term, China can sur-
pass Japan as a major market for wealth
management," says Kaven Leung, who
oversees Citigroup's private banking ef-
forts in China.

Diamond watches. Armani suits. Silver
Bentleys. Private banks. Getting rich in
today's China is indeed glorious, and
spending is even better. ■

BusinessWeek online For a look at how
China's wealthy live, go to
www.businessweek.com/extras

ENERGY

OIL PRICES:
THE NEW REALITY

Futures traders are already assuming sky-high prices are here to stay

BY STANLEY REED

EVERYONE KNOWS IT: OIL prices have gone through the roof. The price of benchmark crude rose 11% this year alone, to about \$67 per barrel, before pulling back a little. But many in the industry have always figured that prices would sooner or later simmer down. One indication: Even when short-term prices soared to alarming levels, the futures market had until recently valued oil much more modestly. As new supplies came onstream, traders figured, prices would drift back down to their long-term average, which for years was about \$20 per barrel. This thinking still influences the big oil companies, who have held back from investing massively in new projects.

But the futures market is now sending a radically different, and disturbing, message. Until 2002, oil futures rarely moved above \$20 per barrel, and by 2005 they still lagged current prices. But in the last year long-term futures prices have been soaring, reaching \$62 per barrel for benchmark West Texas Intermediate crude for delivery seven years out. Paul Horsnell, an analyst at London-based investment bank Barclays Capital, says the markets are sending a message: "Whatever the long-term price is," he says, "it is not \$20 per barrel."

Horsnell and other analysts believe a profound rethink about prices is occurring, with the market trying to figure what price will spur new production without killing demand. As a result, they say, the world has to prepare itself for a long stretch of oil at \$50 to \$60

or higher. There are plenty of reasons for the shift. New reserves from non-OPEC countries aren't materializing. Countries with big reserves such as Iraq and Iran are either unable or unwilling to develop them. Spare capacity in the world's oil fields is almost nonexistent, as demand continues to soar. Göran Trapp, managing director of commodities at Morgan Stanley in London, also notes that fast-growing consumption is outstripping the industry's storage and distribution system. He uses a homey metaphor to explain the predicament: "If your family doubles in size but your fridge stays the same, there is a risk you will run out of milk."

RAZOR-THIN

SHORT-TERM AND long-term prices would both ease if the world had more excess petroleum capacity. But right now spare capacity is a razor-thin 1.5 million to 2 million barrels a day, nearly all of it in Saudi Arabia. That's around 2.5% of world production, a very small margin for error. And it's even worse than it seems because refiners sneer at the heavy sulphurous crude oil that makes up much of the extra oil supply.

Horsnell thinks that it might take spare capacity of as much as 10%, or 8 million barrels, to calm the market's fears of disruptions. The best way to boost world output would be through increases in production from Iraq and Iran, which have large reserves. If these two countries were producing a combined 10 million barrels per day rather than the cur-



IRAQI DISRUPTIONS
Oil pipelines burn west of Kirkuk

rent total of 5.6 million barrels, prices would likely be a lot lower. But will be tough for ei-

country to attract the billions in investment needed to reach such levels.

The rest of the oil patch is struggling, too. Year after year the growth of production in non-OPEC countries, where big international companies have focused most of their efforts, has been disappointing. Last year, despite a surge in production from Russia and Angola, non-OPEC output did not grow at all because of sharp drops in output in the U.S. and the North Sea. Off the coasts of Britain and Norway. At the same time, world demand grew by 1.52 million barrels a day. All of the extra oil had to be made up from OPEC.

Some observers still think that oil prices could come tumbling down. But even if the cost of finding and developing new oil today, there is no reason why the long-term price should be at \$50-plus," says Leo Drollas, deputy director of the Center for Global Energy Studies, a London-based think tank. Drollas theorizes that a surge of hedge fund capital has pushed futures prices up, temporarily altering market dynamics.

Maybe so, but there seems to be a chance of a quick escape from prices that would have been considered astronomical a few years ago. ■

No Relief?
Oil price per barrel for delivery seven years out*

JAN. 25, 2003

\$23

JAN. 25, 2005

\$40

JAN. 25, 2006

\$62

*West Texas Intermediate
Data: Bloomberg Financial Markets

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I SURVIVED ENRON

**Tales of Rejection,
New Starts, Justice, and
True Love**



CHRISTOPHER PALMERI

The current remake of *Fun with Dick & Jane* stars Jim Carrey as a spokesman for a giant corporation that collapses in Enron-like fashion while he's on television promoting it. Humiliated and unable to find another corporate job, Dick becomes a greeter at a discount store and a day laborer before resorting to armed robbery with his wife, played by Téa Leoni. **J**The real-life Enron Corp. saga is back in the news with the expected start on Jan. 30 of the criminal trial of the company's two top former executives: Chairman Kenneth L. Lay and CEO

ey K. Skilling. The case promises seething betrayal, preening lawyers, and long, dry patches of testimony on accounting. government witnesses such as disgraced former Chief Financial Officer Andrew S. Fastow—the inventor of all those off-book partnerships—will swear that Lay and Skilling knew about the rampant fraud. The defense will plead ignorance. Outside the courtroom, cable-TV legal experts will declare daubitories and defeats despite having no idea what's really going through the minds of the 12 jurors.

For the majority of Enron's former employees—31,000 once asked for the company—life has gone on far from the scandal's glare. Thousands saw part or all of their retirement savings wiped out because, with the company's encouragement, they had put it into Enron stock. None is known to have descended to the *Dick & Jane* level of criminal desperation, but many haven't exactly had a red carpet rolled out for them.

Lyde Johnson, who wrote software applications and provided tech support at Enron, says that for four years he has been unable to find full-time employment because of a glut of tech workers in Houston. Last year, Johnson, a 37-year-old U.S. Marine Force veteran and single parent of two, filed for bankruptcy court protection from his creditors. Now, he says, he's losing his house. "I've heard employers tell me: 'You're not going to get Enron money here,'" he says.

Many Enron refugees have bounced back without the company's demise. They've turned up at Microsoft, Boeing, and other corporate giants. Rebecca P. Mark-Jusbasche, once the company's glamorous international dealmaker, manages a family cattle ranch near Taos, N.M., and serves as a director of a small California company that sells water purification systems to developing countries.

Some of the most intriguing post-Enron tales come from people who walked away with neither fame nor millions of dollars. Eric Thode, a public-relations employee, started a company that cleaned up bloody crime scenes. When that didn't take him to the top, he got a business-development job at an oilfield-services company. He's also chairman of the Republican Party of Fort Bend County, Tex., where he has been organizing support lately for Tom DeLay, the indicted former Majority Leader of the House of Representatives.

After losing her job at Enron, accountant Lisa Bromiley says she endured six months of potential employers asking her the same question: "So, were you corrupt or were you

stupid?" Today she's the CFO of Flotek Industries Inc., a fast-growing maker of chemicals and drilling tools for oil companies. "There's two ways to look at a situation like Enron," says Adam Plager, who managed programmers at Enron and now runs his own software company in Houston. "You can say: 'Oh, this is horrible,' or, 'O.K., what did I learn from it?'"

"All of these people were very talented and were able to sell themselves," says Philip H. Hilder, a Houston attorney. He represents a dozen former Enron employees, including whistleblower Sherron Watkins, who now counsels companies on ethics. She's not alone in squeezing lemonade from the ultimate corporate lemon. Kenneth Horton, who did corporate risk assessment at Enron, advises companies on how to comply with the Sarbanes-Oxley Act, the law enacted in 2002 that's designed to prevent future scandals. Horton says he doesn't mind discussing Enron with his clients: "They figure I must have learned what not to do."

In some ways, Enron already seems a thing of the dusty past. The company's crooked E, which came to symbolize an era of corporate excess, is gone from the front of Enron's former downtown Houston headquarters. One of the company's two glass office towers is now occupied by Chevron Corp., the kind of old-school energy business that cocky Enron executives used to snicker at. A few blocks away in a high-rise above a mall, the 300 employees who still pull salaries from Enron work at selling off its remains. Enron's name doesn't even appear in the lobby directory.

For some Enron alumni, the trial will reignite years of resentment. David Tonsall, a former energy efficiency manager, plans to work some late shifts at the Anheuser-Busch Cos. brewery in Houston, where he now oversees a production line, so he can attend the opening days of the trial. "Lay and Skilling ran from their troubles," Tonsall scoffs. "I say: 'Be a man and take responsibility for the things you do.'" At the federal courthouse, Tonsall, a part-time rapper who goes by the name NRun, plans to hand out copies of his self-produced Enron-themed CD, which features a song entitled *Drop the S of Skilling*.

Here, for better and sometimes worse, are five stories of ex-Enronites. For some, such as aspiring entrepreneur Eric Eden,

BusinessWeek online For more tales of how Enron survivors have fared, go to businessweek.com/extras

Plus:
**The Big Trial &
History's Verdict**
Page 58

**Does Corporate
Crime Pay?**
Page 60

getting laid off was just the kick in the pants he needed. For others, such as Diana Peters and Richard Rathvon, Enron's collapse brought out their inner activist. Sanjay Bhatnagar and Andrea Miller may have been the luckiest of all: They emerged from the corporate ruins to find love.

The Brain

IT WAS JUNE, 2002, six months after Enron sank into bankruptcy. At a conference in Crete on mathematics and finance, Vince Kaminski struck up a conversation with a French PhD candidate. He mentioned that he had worked at Enron. "She looked at me, said 'mon Dieu!', and walked away," Kaminski recalls.

The first couple of years were rocky for the man who once ran Enron's 50-person quantitative modeling group. They were the brainy researchers who calculated risks related to energy trading. The problem for Kaminski was that after Enron disintegrated, energy trading dried up in Houston. He did stints at a Chicago hedge fund and a trading outfit in Stamford, Conn., shuttling home to his family in Houston on weekends. On the plane from New York's LaGuardia airport on Friday nights, he would look around and see the cabin dotted with other Enron refugees. His wife, Ludmila, had to care for their wheelchair-bound adult son, who suffers from muscular dystrophy and lives at home. "This was a very stressful time," Kaminski says.

The risk expert had some things going for him, however.

Kaminski, who was born in Poland and has a PhD in theoretical economics from the Soviet-era Main School of Planning Statistics in Warsaw, is respected in his abstruse field. And after working at Enron for 10 years, he left without being accused of any wrongdoing.

In 1999, Kaminski says he had strongly objected to the creation of one of the off-balance-sheet partnerships that later got the company in trouble. As punishment for his impertinence, he says, then-President Skilling moved his group several floors away from the energy traders. "It was very unpleasant at the time to be pushed aside," Kaminski says, "but now I am very glad." He says he initially thought the partnerships were an unwise risk but didn't realize they might be illegal until September, 2001, when his staff was given access to information about them. (Skilling's lawyer, Daniel Petrocelli, says that his client never punished Kaminski and claims that the risk expert was "fully aware" of how the partnerships worked.)

Last year, Kaminski's luck turned. Energy trading was coming back to life in Houston. In March, he was chosen to head quantitative research for Citigroup's global commodities-trading unit in Houston. He recently edited the third edition of *Managing Energy Price Risk: The New Challenges and Solutions*, a \$178 book that's a standard reference in its field.

Kaminski is proud of his innovations back at Enron and says that some aspects of the risk models he helped design are only now being adopted by other big companies. Still, he doesn't boast about the old days: "I try to avoid any conversation about it in public anymore."

Kaminski now measures risk for a Citigroup trading unit



The Toiler

KEN DIANA PETERS THINKS ABOUT THE MILLIONS that top Enron executives lavished on themselves, she says, "it still makes me sick to my stomach." They "will never be in the same financial condition I'm in."

Late 2001 couldn't have been a darker time for Peters. During Thanksgiving week her husband, Dale, was diagnosed with an inoperable brain tumor. The following Monday, when she went to work at her tech-support job at Enron, the boss announced that everyone had 30 minutes to collect their personal belongings and leave. "By 9 a.m. I had no job, my husband had a brain tumor, and I wasn't sure if I was going to have health insurance," Peters recalls. Later she learned she would lose \$5,000 in retirement savings.

Peters' Enron journey had begun in 1991 when, a nurse eager for a career change, she went to work at the energy company. "I loved the fact that they were really involved in the community," she recalls. "I liked what I heard about Ken Lay," that he was family-oriented. Peters landed a job as a clerk and moved quickly through departments, working in engineering and then the new broadband unit. "I could grow; there was a lot of potential," she says. "There was a healthy atmosphere. The people were fun."

That all changed with Enron's bankruptcy and the layoffs. Thanks to Medicare and Social Security payments, Peters has been able to cover her husband's medical expenses. He lives with her, requiring nursing care during the day. Peters, though, hasn't been able to find another full-time job. She picks up temporary work, which does not provide her with health insurance. For extra money, she and her son, Eugene, 27, clean offices on weekends. "At 55, I should have been able to retire," she says. "Instead, I'm starting over."

Even as she has toiled to make ends meet and care for her husband, Peters has found time to fight back against the company that left her jobless. She co-founded the Severed Enron Employees Coalition, which helped win additional severance payments from the company. She also mails scores of letters to politicians, judges, and other prominent figures, urging them to urge federal bankruptcy law to require insolvent companies to provide, among other worker protections, health-care benefits for at least 18 months to those on medical leave at the time of the bankruptcy. It's a long-shot cause that so far hasn't yielded results, but Peters says she still has faith in government and even hope for the future. "Business. We can make Corporate America respect its employees," she says, "so they're not just thrown on the streets like we have been."

Peters still has to clean offices on weekends to augment her income



gy deal. Where was his bonus? "It just wasn't fair," he says.

He and nine other former employees chipped in \$300 each and hired Houston bankruptcy attorney David McClain. With McClain's help, the group established a special committee representing their interests in Enron's bankruptcy proceedings—an unusual accommodation for ex-employees. Rathvon cut a deal with other creditors: In exchange for up to \$13,500 each in immediate severance from Enron, the 4,500 former workers he came to represent gave up any future claims they had against the company. The Rathvon group also won the right to seek the return of the \$103 million in 11th-hour bonuses.

Rathvon argued that it was fraud to enrich a few top executives just before a bankruptcy filing. Enron had been in such a rush to get the money out that it had flown representatives to meet some of the traders in airport bars, handing them checks worth hundreds of thousands of dollars apiece. Last month a federal judge in Houston sided with Rathvon and ordered the traders and executives who hadn't already settled to send their bonuses back.

It wasn't an easy march through the courts for Rathvon. A 54-year-old former lawyer with a salesman's smile and handshake, he says his wife initially hounded him to devote less time to the legal campaign and more to finding a new job. "She kept asking me for my call reports," showing which potential employers he was contacting. He's back in industrial sales, this time for Houston-based Reliant Energy Inc., and doesn't crow about his unlikely role as courtroom crusader. "It was the right thing to do," he says.

The Inventor

ERIC EDEN HAD SPENT a lot of time thinking about his lawn sprinkler, a significant concern in scorching east Texas. Eden, who lives in suburban Houston, didn't want to move his sprinkler every time he mowed the grass. He didn't like running across wet turf to reposition the thing, either. Then sudden-

Rathvon won employees greater rights in Enron's bankruptcy proceedings

The Advocate

HARD RATHVON WAS MAD AS HELL when Enron laid him off in December, 2001. A salesman in the industrial energy unit, he was even angrier when he learned that Enron had paid 56 top traders and executives \$103 million in "retention bonuses" in the days before the company declared bankruptcy. Rathvon himself was owed \$10,000 for putting together a big ener-



Bhatnagar and Miller, now engaged, met while working for Enron in India

ly in December, 2001, he could ponder the mechanics of lawn maintenance at leisure. His lucrative job at Enron, drafting plans for new power plants and pipelines, had disappeared.

The father of two might have despaired. Instead, he felt liberated. He had always dreamed of starting his own business. Now he would bring the world a better sprinkler. His innovation: plant the sprinkler head in the ground and attach a hose to it when it's time to water. That way the sprinkler is positioned where the user wants it, but installation is a lot easier and cheaper than laying pipe underground.

An experienced handyman, Eden built his Original Sprinkler Station with store-bought parts and sold the first 75 at a local home show for \$40 apiece. Hardware stores balked at first, but he had a breakthrough at his neighborhood Lowe's. Soon Eden's sprinklers were selling in most Lowe's stores west of the Mississippi, and this year he'll go nationwide. At a trade show in Las Vegas in 2004, his product caught the eye of buyers for the QVC shopping channel. His debut on the network last April sold 1,800 sprinklers. He's scheduled to make his fourth appearance this spring.

Eden, 37, predicts that his company, Watering Made Easy, will gross \$600,000 this year, double last year's sales. He has contracted out his manufacturing and distribution but runs the outfit from a small room just off his living room that's crammed with sprinklers and electric guitars. "It's real life here," he says, nudging aside a dirty sock.

Eden says he feels no anger toward Enron, where he worked for eight years. "Enron was about empowering you, letting you run with your ideas and succeeding or failing for yourself," he says. Without that experience, he says he wouldn't have started his own business and the Original Sprinkler Station wouldn't have had its day in the sun.

The Lovebirds

BEFORE MOST PEOPLE HAD HEARD of Enron's shady side deals and manipulation of electricity prices in California, the company's biggest black eye was the Dabhol power plant in India. Spearheaded by Enron's top international executive, Mark Jusbache, the \$2.9 billion project initially symbolized the company's global vision and derring-do. And it was there, in 1997, that Sanjay Bhatnagar, a charming Harvard Business School grad supervising the project for Enron, got to know



Andrea Miller, a former energy consultant on the company's international finance team.

Dabhol's high-priced power was a source of perennial controversy in India, and local politicians reneged on contracts with Enron. These troubles contributed to a critical shift within the company in the late 1990s. Mark Jusbache, once viewed

as a possible successor to Lay, was passed over in favor of Skilling, who began de-emphasizing power projects and pipelines in favor of an "asset-lite" strategy built around the trading business he led. All that seemed like bad career news for Bhatnagar and Miller, so they left the company in the summer of 2000. Miller, now 34, got her MBA from Columbia University. Bhatnagar, 44, formed an investment partnership that bought power plants in Europe.

They defend what they were doing at Dabhol, which, they say, needed Enron's power. "It's poetic justice now that there are blackouts and brownouts" in the region, Miller says. Adds Bhatnagar: "The real story is what survived of Enron today. Ultimately it's the hard assets that are still successful." Perhaps, but not the Dabhol plant. It remains in mothballs.

Getting laid off gave Eden the push to start his lawn sprinkler business

Bhatnagar and Miller reconnected in New York in 2001 and this time discovered that they had more in common than respect for Enron's hard assets. Last year they were engaged to be married. "One of the few positive things to come out of Enron," Miller says. Today Bhatnagar is an investor in Miller's new business, *Tango*, a magazine that she launched last year. Miller sees it as the thinking woman's *Cosmopolitan*, with a sharp focus on relationships. The magazine appears six times a year and has a circulation of 200,000. Vertivisers include Christian Dior and Elizabeth Arden.

As for their own relationship, the couple has not set a date for a wedding. Miller attributes this to the culture they learned at Enron. "We continue to work like crazy people," she says. "I just haven't had time." ■

—With Peter





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COMMENTARY

Ken Lay's Audacious Ignorance

Even if one of America's worst ex-CEOs beats the rap—and he just might—history's verdict will be harsh

BY ANTHONY BIANCO

THE ONLY REMAINING QUESTION OF GREAT consequence about Enron is whether its prime movers, Kenneth L. Lay and Jeffrey K. Skilling, will go to prison for their part in its transformation from icon of New Age corporate cool to synonym for Bubble Era greed and deceit. As the pair go on trial on Jan. 30 in Houston, it will be important to keep in mind that the jury's decision will serve only to fix criminal culpability. Even if Lay and Skilling are acquitted, the trial holds zero hope of redemption for Enron's Big Two. History's verdict is already in, and it is harsh: As two of the most inept executives in business history, Lay and Skilling are heavily to blame for the demise of a company that once employed 31,000 people and had a stock market value of \$35 billion but which survives today in shriveled form under the protection of the bankruptcy code.

Although the brash, combustible Skilling, now 52, makes a more flamboyant villain, the burden of responsibility falls mainly on the smoothly self-effacing Lay, 63. After all, Lay was Enron's highest-ranking executive from 1986 until the company filed for bankruptcy protection from its creditors in late 2001—both as CEO (except for a six-month stretch when Skilling held the job) and as chairman throughout. A prolific Republican Party contributor nicknamed “Kenny Boy” by President George W. Bush, Lay not only was The Man at Enron, once America's seventh-largest company, but also was Houston's most influential power broker for a decade.

Enron's fatal flaws emerged from two contradictory traits that defined Lay as a corporate leader. A PhD economist by training, he was a free-market devotee hell-bent on liberating the natural gas business from the dead hand of regulatory con-

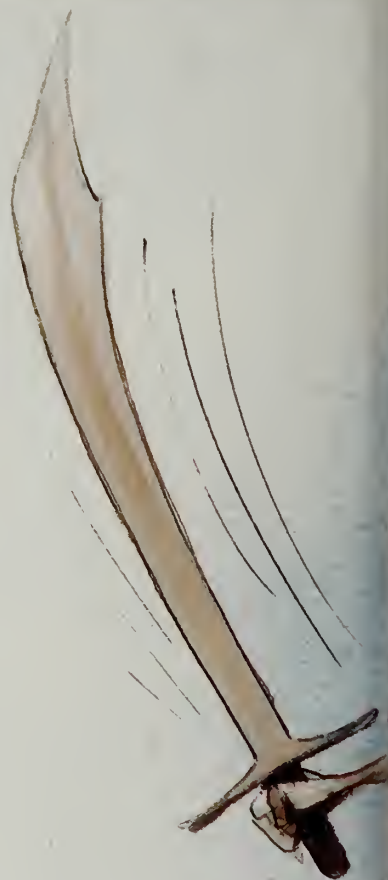
straint. But for all the passion of his intellectual convictions, was a weak, even spineless manager. He soon lost interest in mundane realities of Enron's operations as he concentrated on manipulating the political system, and he made no real effort to control Skilling and his kamikaze minions as they gamed energy markets and U.S. accounting laws. Lay signed off on many crazily convoluted transactions designed to mask high-risk investments gone bad that by the late 1990s most of “cash flow” that Enron was reporting came from the company's dealings with itself.

POWERFUL ROLODEX

LAY'S FAILINGS NOW SEEM to be working to his advantage legally. Since resigning from Enron, he has repeatedly insisted that he was unaware of any wrongdoing committed on his watch. Prosecutors have tacitly conceded the effectiveness of Lay's use of what is known in legal circles as the “idiot” or “ostrich” defense. The indictment handed down against him was narrowly drawn, consisting of seven counts of fraud and conspiracy compared with the 35 counts leveled against Skilling and 98 against former Chief Financial Officer Andrew Fastow, who is set to testify against Lay and Skilling under a plea bargain that limits his prison term to 10 years. Confined almost entirely to Lay's actions during the last few months of 2001, the indictment accuses him of misrepresenting Enron's condition as it careered toward insolvency.

It is entirely possible that Lay will beat the rap. As last year's acquittal of HealthSouth Corp. CEO Richard Scrushy showed, financially complex executive suite prosecutions are proble-

Lay's “ostrich” defense makes it hard for prosecutors to prove Skilling faces times as many





dict against him with a defiant speech on Dec. 13. "Contrary to popular belief today, I firmly believe that Enron was a great company," Lay told some 250 invited VIPs at the Houston Forum. If not for the wrongdoing of "less than a handful" of rogue employees, he added, Enron would not have gone belly-up and would "still be a great and growing company today."

CORRUPTION INC.

LAY'S POWERS OF SELF-DELUSION appear intact, but his fall from power has deprived him of the ability to count. To date, prosecutors have collected guilty pleas from 16 of his former colleagues, including Chief Accounting Officer Richard A. Causey as well as CFO Fastow. Another Enron manager was convicted at trial, along with four outside investment bankers. Five more Enron executives will go before a jury this fall. Factor in the 100 or so unindicted co-conspirators mentioned in the various cases, and it is plain that what differentiated Enron from Tyco, WorldCom, and the era's other A-list corporate miscreants was not just the rococo sophistication of its dealings but also the sheer number of diligent, highly educated people that it corrupted.

Enron never was a great company, although it did have its transcendent moments. Lay's only significant accomplishment came at the outset, with the mid-1980s reverse takeover that birthed Enron from two old-line gas pipeline operators, InterNorth Inc. and Houston Natural Gas Co. Lay was CEO of the latter company, which was one-third InterNorth's size, but after much boardroom finagling, he emerged as top dog at Enron, the successor to InterNorth. With 37,500 miles of pipeline, Enron was the largest U.S. distributor of natural gas and seemed ideally positioned to profit as the deregulatory steps Lay had championed finally came to pass.

However, neither Lay nor anyone else at Enron was able to devise a business model to capitalize on a deregulatory process that proved frustratingly slow, erratic, and politically compromised. In fact, Lay's managerial shortcomings nearly doomed Enron in the cradle. One of its few profitable businesses at the outset was a small but hyperactive oil trading desk that InterNorth had set up in a suburb of New York. Lay and other Houston execs ignored mounting evidence of irregularities at the oil unit until disaster struck in 1987, according to a government filing in federal court in Houston. The subsidiary's top two traders pleaded guilty to felonies. Enron was stuck with oil contracts that could have bankrupted it had not a successful salvage operation reduced pretax

losses to \$140 million from a potential \$1 billion.

It was only after Lay enticed Skilling away from McKinsey & Co. in 1990 that Enron revved up its growth rate and developed its trademark swagger. Skilling, an inventive and outlandishly ambitious executive, devised a brilliant scheme for trading gas supply contracts. But the company spun out of control as it tried to sustain its momentum by increasingly resorting to accounting legerdemain and trading-desk trickery. Like many of the dealmakers who worked under them, Lay and Skilling were so smart they were stupid—blinded to the colossal risks that Enron routinely took by a fateful mix of hubris and desperation. ■

definition. Fraud and conspiracy are crimes of commission, not omission—Lay's managerial forte. Lay "glided on the tails of others and a Rolodex of influential relationships," says Jeffrey A. Sonnenfeld, senior associate dean at the Yale School of Management and founder of the Chief Executive Leadership Institute. "When he sensed dangerous truths, he hid his job as one of containment, rather than showing courage or character."

Lay is as audacious a defendant as he once was a corporate notor. Even as the disgraced ex-CEO was readying himself for trial, he launched a PR campaign to overturn history's ver-

White-Collar Crime: Who Does Time?

Corporate criminals are punished more harshly today than in the '80s, but hands-off executives may still face better odds

BY JANE SASSEEN

DOES CORPORATE CRIME PAY? THE record can seem pretty arbitrary. Tyco International Ltd.'s L. Dennis Kozlowski and WorldCom Inc.'s Bernie Ebbers got hammered for their misdeeds. But plenty of other corporate and financial titans at companies engaged in chicanery have come away only mildly bruised. Michael Milken, the embodiment of an earlier generation of scandals, served less than two years and left prison in 1992 with a fortune of roughly \$500 million. Banker Frank Quattrone, a key figure in the more recent brouhaha over allocation of initial public offerings, faces 18 months and will keep much of the \$200 million he made in the late 1990s.

Some beat the rap altogether. HealthSouth Corp.'s Richard M. Scrushy, acquitted of charges he directed a \$2.7 billion fraud, remains one of the largest shareholders of the chain of rehabilitation centers. A host of others at scandal-wracked companies, such as Global Crossing Ltd. founder Gary Winnick, pocketed millions from stock sales and faced no criminal or civil charges at all.

As haphazard as these outcomes may appear, there are rules of thumb to keep in mind as the trial of Enron Corp.'s Kenneth

L. Lay and Jeffrey K. Skilling gets under way in Houston. Here are a few:

MORE PUNISHING TIMES Generally speaking, convicted corporate figures get punished more harshly today than they did in the late '80s and early '90s. Milken, now-defunct Drexel Burnham Lambert's king of high-interest "junk" bonds, pleaded guilty to conspiracy and securities fraud in 1990 in

exchange for a 10-year sentence, later reduced to 22 months of good behavior and cooperation with prosecutors. A defendant of his notoriety would not get off as lightly today, according to veteran prosecutors.

Federal sentencing guidelines, which weren't in effect when

Milken's crimes took place, have ratcheted up penalties for white-collar offenders, particularly where huge shareholder losses are involved. Attitudes have also changed. Public outrage over Milken's stock-manipulation schemes was relatively muted because the victims were primarily companies and faceless institutional investors. In the late 1990s, however, roughly half of American households had piled into the stock market, according to the Investment Company Institute, many through retirement plans. When the bubble burst in 2000, legions saw their brokerage accounts and 401(k) balances dip sharply. As it became clear that fraud lay behind some of the biggest corporate collapses, a large constituency demanded severe consequences, says Ira Sorkin, a former prosecutor and official with the Securities & Exchange Commission now in private practice. "Middle America lost a lot of money, which has led to cries for tougher enforcement to put the scoundrels away," he says.

Financial penalties have become stiffer. Convicted in July of orchestrating the \$11 billion accounting fraud at WorldCom, onetime billionaire Ebbers has little left to his name after settling

with regulators, shareholders, and his former company. Adelphia Communications Corp. founder and ex-CEO John J. Rigas, who received a 15-year sentence on fraud and conspiracy charges related to the looting of the cable-TV provider, faces a similar financial fate. He is appealing.

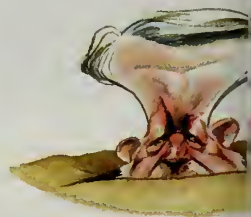
GREED ISN'T A CRIME Many companies played accounting games during the 1990s boom. But neither greed, dubious bookkeeping, nor suspiciously timed trades are necessarily criminal. Prosecutors must demonstrate not only that an action violated a specific law but also that the executive intentionally committed the bad act. "The evidence is very black and white, and the law is often amorphous," says Steve Peikin, a former federal prosecutor now in private practice.



"Junk"-bond king Milken got out of prison after serving 22 months



Global Crossing founder Winnick faced no criminal charges whatsoever



WorldCom's Ebbers could serve 25 years behind bars



o's Kozlowski will spend 25 years in prison if he loses his appeal

work capacity that made it look stronger financially than it is. But the swaps weren't clearly illegal.

Winnick had another big advantage: Unlike Ebbers, he isn't his company's chief executive. As co-chairman of Global Crossing's board, Winnick persuaded investigators that he isn't personally enmeshed in the company's problems. Enron's Lay, who served as both chairman and CEO at various times, is expected to attempt a similar defense.

Quattrone, a star banker at Credit Suisse First Boston, helped peddle hot IPO shares to favored clients and supervised analysts who allegedly boosted wobbly Internet companies. But these practices, distasteful as they are to many, didn't lead to charges because they didn't violate any law. He was convicted of obstructing justice and witness tampering for suggesting, after the ending of a grand jury probe, that workers tidy up their end. He is appealing.

FLOR OR ROLL THE DICE Some of the hit-or-miss feel of white-collar justice stems from the defendant's dicey choice of plea—guilty vs. facing a jury. Given the difficulties of proving complex crimes, prosecutors typically try to strike deals with midlevel executives to build cases against the top bosses. The difference in sentencing can be huge. Compare the five years WorldCom CFO Scott D. Sullivan got for helping prosecutors nail his boss with the 25 that Ebbers might serve.

But juries can exonerate as well as convict. Last summer, Scrushy fended off charges that he was at the center of the accounting fraud that permeated HealthSouth. Prosecutors thought they had a strong case, based on testimony from five former HealthSouth chief financial officers, who all pleaded guilty and implicated Scrushy. But his team poked holes in their testimony, and he played his hometown advantage shrewdly. He drew visible support from black pastors in Birmingham, whose presence as courtroom spectators may have impressed some members of the predominantly black jury. "The world may have thought he'd be convicted, as they now think Ken Lay and Jeff Skilling will be," says Robert Morvillo, a New York defense lawyer. "But trials take on a life of their own." ■

—With David Polek

HealthSouth's Scrushy was exonerated by a hometown jury



Courthouse Scorecard

The Enron Task Force so far has charged 34 defendants. As the trial of Kenneth Lay and Jeffrey Skilling begins, here's a sampling of where various cases stand:

AWAITING TRIAL



KENNETH L. LAY
Chairman and CEO
» Fraud, conspiracy, and making false statements



JEFFREY K. SKILLING
CEO
» Insider trading, fraud, conspiracy, and lying on financial statements

GUILTY PLEAS



ANDREW S. FASTOW
CFO
» Conspiracy to commit securities and wire fraud
» Awaiting sentencing



LEA W. FASTOW
Assistant treasurer
» False federal income-tax return
» 1 year in prison



RICHARD A. CAUSEY
Chief accounting officer
» Securities fraud
» Awaiting sentencing



BEN F. GLISAN JR.
Treasurer
» Conspiracy to commit wire and securities fraud
» 5 years in prison



MICHAEL J. KOPPER
Aide to CFO Fastow
» Money laundering and conspiracy
» Awaiting sentencing



KENNETH D. RICE
Co-head of Enron Broadband Services
» Securities fraud
» Awaiting sentencing



KEVIN P. HANNON
COO of Enron Broadband Services
» Conspiracy to commit securities and wire fraud
» Awaiting sentencing



JOHN M. FORNEY
West Coast power trader
» Conspiracy to commit wire fraud in manipulation of California energy market
» Awaiting sentencing



LAWRENCE M. LAWYER
Held several relatively low-level positions
» False federal tax return
» Awaiting sentencing



PAULA H. RIEKER
Director of investor relations
» Insider trading
» Awaiting sentencing

JURY CONVICTION



DAN O. BOYLE
Vice-president of Enron's Global Finance group
» Conspiracy to commit wire fraud and falsify records; lying to a congressional investigator
» Convictions relate to Nigerian floating power-plant deal with Merrill Lynch; four Merrill executives were also convicted and sentenced to prison terms; one Enron executive acquitted
» Boyle sentenced to 3 years, 10 months

AWAITING RETRIAL



JOSEPH HIRKO Co-head of Enron Broadband Services
» Acquitted of some insider trading and money laundering charges; mistrial on other charges; scheduled to be retried with four other former broadband executives in September, 2006



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Steve Jobs' Magic Kingdom



How Apple's demanding visionary will shake up Disney and the world of entertainment **BY PETER BURROWS AND RONALD GROVER**

LY ON A JULY WORKDAY IN 1997, JIM MCCLUNEY, THEN chief of Apple's worldwide operations got the call. McCluney was summoned with other top brass of the beleaguered company to Apple Computer Inc.'s boardroom on its Cupertino (Calif.) campus. Embattled Chief Executive Gil Amelio wasted no time. With an air of barely concealed relief, he said: "Well, it's sad to report that it's time for me to move on. Take care," McCluney recalls. And he left.

A few minutes later, he walked Steve Jobs. The co-founder of Apple, once proud company had been fired by Apple 12 years before. He had returned seven months earlier as a consultant, when Amelio acquired his NeXT Software Inc. And now Jobs was back in charge. Wearing shorts, sneakers, and a few days' worth of beard, he sat down in a swivel chair and spun slowly. McCluney, now president of storage provider Emulex, said, "O.K., tell me what's wrong with this place," Jobs said. After some mumbled replies, he jumped in: "It's the products! So it's wrong with the products?" Again, executives began offering some answers. Jobs cut them off. "The products SUCK!" he roared. "There's no sex in them anymore!"

The one-time *enfant terrible* of the technology world has calmed down considerably en route to becoming a 50-year-old billionaire. But what hasn't changed is his passion for doing, and saying, just about anything to help create the kinds of products that consumers love. In the nine years since Jobs returned to Apple, his unique *modus operandi* has sparked broad changes in the world of music, movies, and technology.

Now Jobs is stepping into the Magic Kingdom. On Jan. 24, Walt Disney Co. agreed to pay \$7.4 billion in stock to acquire Pixar Animation Studios, where Jobs is chairman, CEO, and 50.6% owner. As part of the deal, Jobs will become the largest shareholder at Disney and take a seat on the entertainment giant's board. His top creative executive at Pixar, John A. Lasseter, will oversee the movies at both Pixar's and Disney's animation studios. Pixar's president, Edwin Catmull, will run the business side for the two studios.

The alliance between Jobs and Disney is full of promise. If he can bring to Disney the same kind of industry-shaking, boundary-busting energy that has lifted Apple and Pixar sky-high, he could help the staid company become the leading laboratory

for media convergence. It's not hard to imagine a day when you could fire up your Apple TV and watch Net-only spin-offs of popular TV shows from Disney's ABC Inc. Or use your Apple iPhone to watch Los Angeles Lakers superstar Kobe Bryant's video blog, delivered via Disney's ESPN Inc. "We've been talking about a lot of things," says Jobs. "It's going to be a pretty exciting world looking ahead over the next five years."

One reason for the rich possibilities is that Disney CEO Robert A. Iger is a kindred spirit. The 54-year-old Iger, who succeeded longtime Disney chief Michael D. Eisner on Oct. 1, is a self-avowed early adopter who listens to a 120-channel Sirius satellite radio in his car. He travels with a pair of iPods, bopping along to the new nano during his 5 a.m. workouts. Jobs seems to know it: Iger says the first call that he got in March when he was named to the top job came from the Apple CEO. "He wished me well and hoped we could work together soon," recalled Iger in an interview two months ago.

Lightning fast is more like it. Two weeks after Iger took office, the Disney CEO was on stage at a San Jose movie theater with Jobs as the two men introduced Apple's new video iPod and the availability of such ABC shows as *Lost* and *Desperate Housewives*. The deal came together on Internet time, in just three days. Iger wanted to show that Disney can be a nimble company, willing to embrace the latest digital technologies to deliver its content. "I think we impressed [Jobs and other Apple execs] with how quickly we could make a decision," said Iger in the earlier interview.

VINDICATION

YET THE ALLIANCE has plenty of risks, too. Jobs will have to navigate a minefield of conflicts as he runs Apple and sits on Disney's board. He'll also have to demonstrate he can take on the unfamiliar role of supporting player. The same perfectionism that allows him to help create great products has made it difficult for him to stand by if someone is going in what he considers the wrong direction. When he returned to Apple as part of the NeXT acquisition, he insisted he didn't want Amelio's job, and then quickly took charge. Already, there's speculation in Silicon Valley that Disney's chief could get "Amelioed."

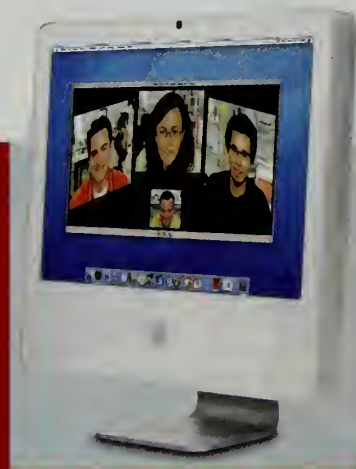
Iger isn't in the most secure spot. He has revamped Disney's management style and has improved some operations. Still, the company's stock is at about the same level it was a decade ago. And Iger has only been CEO a few months, so he's on new footing with Disney's directors. One management expert calls the Jobs move "courageous" but says "Iger just put a gun to his head," predicting that Jobs' influence in the boardroom would be so pervasive that Iger could be gone within a year.

Particularly ticklish will be Disney's animation business.

Redefining The CEO

Just over a decade ago, Steve Jobs was considered a has-been whose singular achievement was co-founding Apple Computer back in the 1970s. Now, given the astounding success of Apple and Pixar, he's setting a new bar for how to manage a Digital Age corporation:

While Iger has stressed that it's crucial to the company's future, Jobs may have closer ties, since his two lieutenants will be running the show. Even during the conference call announcing the Disney-Pixar deal, there were hints of differences. One analyst asked whether Lasseter would have authority to decide whether Pixar movies such as *Toy Story* would be made into Broadway plays. Jobs began by acknowledging that Lasseter works for Iger, then added, "[Lasseter] has always had strong feelings about the exploitation of stories and characters." So if Lasseter and Iger disagree, who would Jobs back? Jobs declined to be interviewed for this a



STRATEGY

Jobs is an obsessive perfectionist who insists on having total control over the most minute product details. That was considered hopelessly idealistic in the lean years as Microsoft and its partners trounced Apple with cheaper PCs. Now, as music, movies, and photography go digital, consumers want elegant, simple devices. And Jobs' insistence on controlling all aspects of a product—from hardware and software to the service that comes with them—is the new blueprint.

But some executives who know him well insist that Iger has nothing to fear. "People are misreading Steve Jobs," says Edgar S. Woolard Jr., the former chairman of Apple and former chairman and CEO of chemical giant DuPont. "If he has a good relationship with you, there is nobody better in the world to work with." Iger made a very wise move, and two years from now even Jobs will be saying that.

Jobs certainly has much to offer. The past few years have been a thorough vindication of his ideas and leadership. A decade ago he was considered a temperamental micromanager whose insistence on total control and stylish innovation doomed his company to irrelevance. While Apple tried to develop both the hardware and software for its computers, Microsoft, Intel, and a flock of PC makers slashed the onetime

LEADERSHIP

At Apple, micromanagement is not a dirty word. While Jobs relies heavily on his expertise in areas of expertise. He demands minuscule changes to product designs, rehearsing hours to perfect his final product introduction presentations and work at length with reporters on stories he wants to be involved with. The downside: Apple won't have a succession plan. This despite the fact that Jobs has much more impact on the company than most CEOs who have undergone cancer surgery in 2004.



try leader to bits by separating the two. Asked in late 1997 at Jobs should do as head of Apple, Dell Inc.'s then-CEO Michael S. Dell said at an investor conference: "I'd shut it down and give the money back to the shareholders."

fighting words that Dell may regret today. Apple shares have red from \$7 a share three years ago to \$74, and the company's market cap of \$62 billion is just shy of Dell's. Why? Jobs applied his old strategy to the new digital world. With absolute control, breakout innovation, and stellar marketing, he

has created products that consumers lust after. The smooth melding of Apple's iPod with the iTunes software has helped make it an icon of



URE

as its advantages. Finding Apple with Stephen Wozniak, Jobs loved that small teams will outperform big ones. He has the same approach at where **creative chief** Laster has led the way **g blockbusters like** *Toy Story* and *Finding Nemo*. outsources far more than his rivals. He'd have all his creatives together than save a by outsourcing such seas.

Digital Age. Rivals Microsoft to Dell to Corp. have been in the dust. "He has the basic model for a digital business now on," says Toshiba Corp. CEO Atsutoshi Nishida. Microsoft is even considering making its own digital music player, since providing its software to Dell and other hardware developers has failed to slow Apple (page 38).

Jobs' success at Pixar is no less remarkable. He bought the business from director George Lucas 20 years ago for \$10 million. Catmull and Lasseter believed they could use computer animation to create full-length movies, even though many in Hollywood and at Disney thought computers could never deliver the nuance and emotion of hand-drawn animation. Jobs brought it into the vision. The result: Pixar has knocked out six

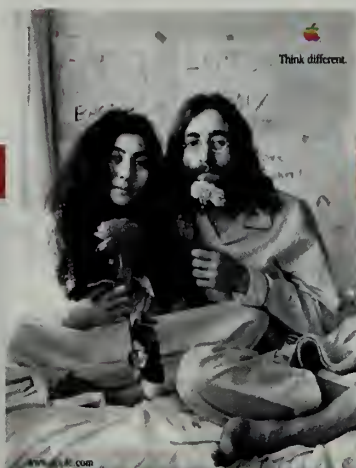
blockbusters, from *Toy Story* in 1995 to *Finding Nemo* and *The Incredibles* in recent years. "The great thing about Steve is that he knows that great business comes from great product," says Peter Schneider, the former chairman of Disney's studio. "First you have to get the product right, whether it's the iPod or an animated movie."

Of course the trick isn't in wanting to make great products. It's being able to do it. So what is Jobs' secret? There are many, but it starts with focus and a near-religious faith in his strategy.

For years, Jobs plugged away at Apple with his more proprietary approach, not worrying much about Wall Street's complaints. In fact, one of his first moves

INNOVATION

Other CEOs may focus on finance or sales. Jobs spends most of his time trying to come up with the next blockbuster product. Think **iPod and iTunes**. As a tech pioneer, he doesn't have to depend on lieutenants for technology smarts or product taste. To keep on top of the latest technologies, he personally meets not only with suppliers but also sometimes with suppliers' suppliers.



MARKETING

Tech companies have long been ham-handed marketers. Their best is usually utilitarian or cute (remember "Dude, you're getting a Dell"?). Yet Apple has consistently stood out for aspirational ads with a heavy dose of counterculture rebellion. The **"Think Different"** series featured John Lennon, Rosa Parks, and Pablo Picasso. The message isn't about trimming costs by 10%. It's this: If you dream of changing the world, we want to help you do it. Jobs even had a hand in writing the copy.

was to take an ax to Apple's product line, lopping off dozens of products to focus on just four. "Our jaws dropped when we heard that one," recalls former Apple chairman Woolard. Time and again since, Apple has eschewed calls to boost market share by making lower-end products or expanding into adjacent markets where the company wouldn't be the leader. "I'm as proud of what we don't do as I am of what we do," Jobs often says.

It's all based on a fundamental belief that a killer product will bring killer profits. That's certainly the case at Pixar. While analysts have often urged the company to crank up its movie machine and pump out more releases, the company is only now reaching the point that it can make one a year. And at least until the Disney deal was struck, the plan was to stay there for

PARTNERING

Jobs chooses his partners carefully. He burnishes his image by associating with artists like U2. Yet he can be a brutal negotiator. **His personal clash with ex-Disney CEO Michael Eisner** destroyed negotiations over distributing Pixar movies and contributed to Eisner stepping down. And Jobs never told Motorola that on the same day Motorola and Apple unveiled their Rokr iTunes phone, he was going to announce the iPod nano. Sources say Moto execs fumed that the nano stole its thunder.



(IMAC) COURTESY OF APPLE; (TOY STORY) WALT DISNEY PICTURES/ZUMA PRESS; (JOHN AND YOKO) CASLIGHT AD ARCHIVES; (JOBS) JEFF CHIU/AP/WIDE WORLD; (IPOD) COURTESY OF APPLE; (EISNER) ROSE PROUSER/REUTERS



good. The reason: Pixar's executives focus on making sure there are no "B teams," that every movie gets the best efforts of Pixar's brainy staff of animators, storytellers, and technologists.

Indeed, Jobs says with pride that Pixar has made the tough call to stop production at some point on every one of its movies to fix a problem with a storyline or character. "Quality is more important than quantity, and in the end, it's a better financial decision anyway," Jobs told *BusinessWeek* last year. "One home run is much better than two doubles," he said, explaining that then there's only one marketing and production budget rather than two.

The fixation on quality over quantity refers to personnel as much as production. Ever since the days when he marveled at Stephen G. Wozniak's engineering skill while building the first Apple computer, Jobs believed that a small team of top talent can run circles around far larger but less talented groups. He spends a lot of energy working the phones, trying to recruit people he has heard are the best at a certain job.

"BENEVOLENT BENEFACTOR"

THIS IS ONE REASON THAT Jobs, while a micromanager at Apple, plays a very different role at Pixar. He handles many of the business duties. But he's very hands-off on the creative side. Sources say he typically spends less than a day a week at the company's picturesque campus in Emeryville, across the San Francisco Bay from Apple's Cupertino headquarters. "Steve doesn't tell us what to do," says one Pixar employee. "Steve's our benevolent benefactor."

Jobs may be a multibillionaire, but that hasn't cut into his work ethic. He brings an entrepreneur's energy to tasks many CEOs would see as beneath them, whether it's personally checking the fine print on partnership agreements or calling reporters late in the evening to talk over a story he thinks is important. And Jobs seems perfectly willing to forgo some aspects of the executive life to focus on his own priorities. For example, unlike most CEOs he rarely participates in Wall Street analyst conferences.

GADGET GEEKS Jobs and Iger have proved their agility in dealmaking

His famous keynote speeches are maybe the best example of his intensity. In trademark jeans and mock-turtleneck, Jobs unveils Apple's latest products

as if he were a particularly hip and plugged friend showing off inventions in your living room. Truth is, the sense of informality comes only after grueling hours of practice. One retail executive recalls going to a Macworld rehearsal at Jobs' behest, then waiting four hours before Jobs came off the stage to acknowledge his presence. Run perhaps, but the keynotes are a competitive weapon. Marissa Mayer, a Google Inc. executive who plays a central role in launching the search giant's innovations, insists that up-and-coming product marketers attend Jobs' keynotes. "Steve Jobs is the best at launching new products," she says. "They have to see how he does it."

Of course, that entrepreneurial zeal is there for a reason: He's one of a shrinking collection of tech chieftains who are actually entrepreneurs. "I've

very lucky to have grown up with this industry," Jobs told *BusinessWeek* in 2004. "I did everything coming up—shipping, sales, supply chain, sweeping the floors, buying chips, you name it. I put computers together with my own two hands. As the industry grew up, I kept on doing it."

The same can be said of his role as a movie mogul. Following Pixar's hit with *Toy Story* in 1995, Jobs and then-chief financial officer Lawrence B. Levy gave themselves a crash course in movie business economics. That helped Jobs persuade Dis-

Jobs will have to show he can take on the unfamiliar role of supporting player

to agree to a far more lucrative distribution deal than Pixar had in the past. Former Disney executive Schneider, who negotiated that deal with Jobs, says he applies equal parts industry knowledge, intensity, and sheer charisma. Jobs prefers to negotiate one-on-one, and let lawyers tie up the details after a handshake is done. "He says 'Fine, we have a deal,' and you say, 'Wait, wait, I need to check with Michael [Eisner],' and he's saying, 'No, it's done.'"

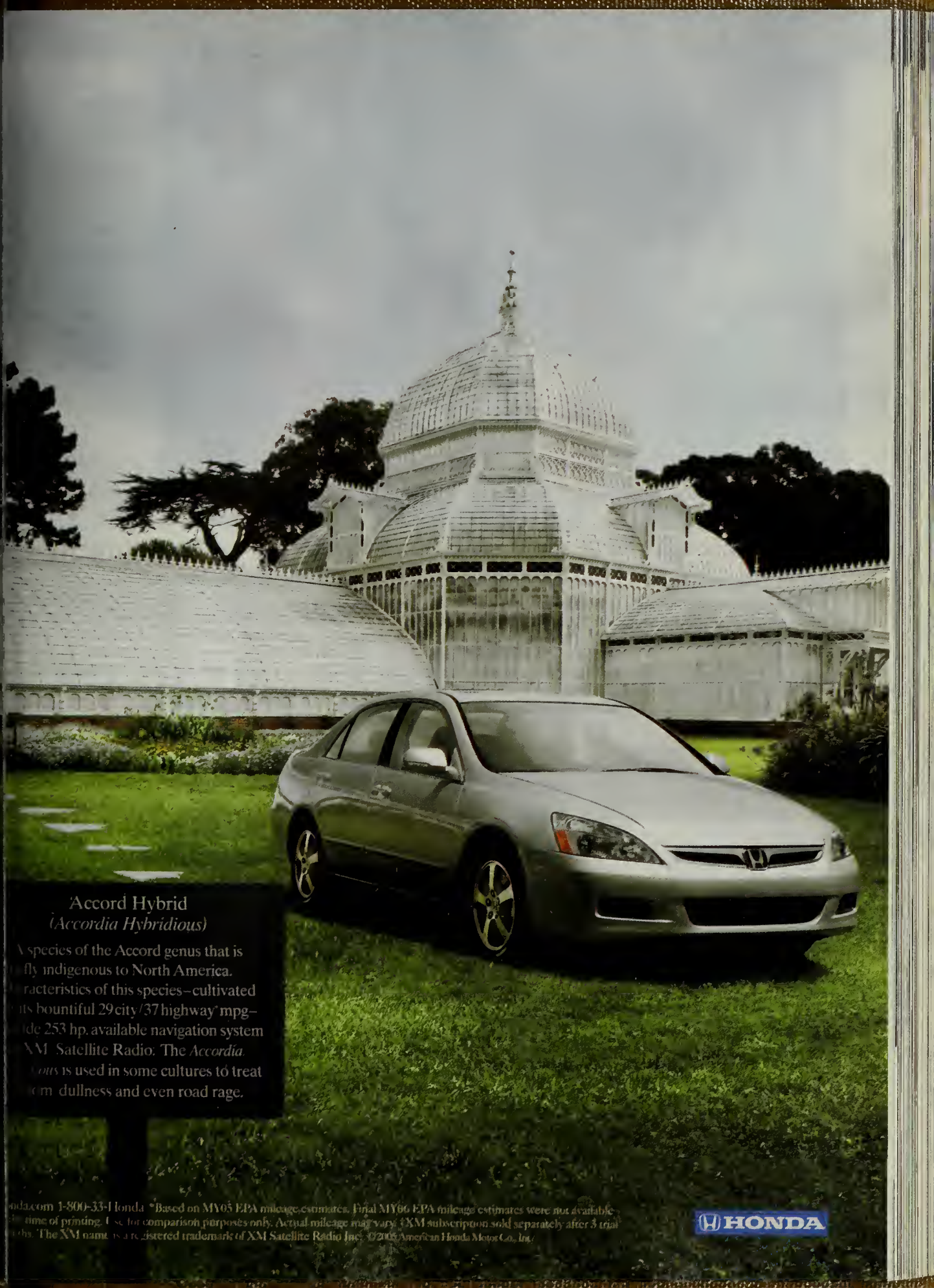
That's not to say Jobs is an easy partner. Unlike every other electronics maker, Apple refuses to let even the biggest retailers know what new products are coming until Jobs unveils them. That means the retailers can't get a jump on arranging advertisements or switching out inventory. But Jobs would rather ride the surge of publicity that comes with his dramatic product launches. Indeed, Motorola executives were furious when Apple

Podcast: Hear The Story Behind The Story

For a podcast interview with Computer Editor Peter Burrows by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

BusinessWeek online

<http://www.businessweek.com/extras>



Accord Hybrid
(*Accordia Hybridious*)

A species of the Accord genus that is
natively indigenous to North America.
Characteristics of this species—cultivated
its bountiful 29 city/37 highway* mpg—
include 253 hp, available navigation system
and XM Satellite Radio. The *Accordia*.
Hybridious is used in some cultures to treat
from dullness and even road rage.

honda.com 1-800-33-Honda *Based on MY05 EPA mileage estimates. Final MY06 EPA mileage estimates were not available
at the time of printing. Use for comparison purposes only. Actual mileage may vary. XM subscription sold separately after 3 trial
months. The XM name is a registered trademark of XM Satellite Radio Inc. ©2005 American Honda Motor Co., Inc.

 **HONDA**

COVER STORY



prised them by announcing the iPod nano last October, stealing the thunder from the iTunes phone that Apple and Moto had developed together.

In the final analysis, Jobs' true secret weapon is his ability to meld technical vision with a gut feel for what regular consumers want and then market it in ways that make consumers want to be part of tech's cool club. Says a leading tech CEO who requested anonymity: "God usually makes us either left brain people or right brain people. Steve seems to have both sides, so he can make extraordinary experiences."

POLARIZING FIGURE

IN THE WAKE OF THE DISNEY-PIXAR deal, the question is how Jobs can apply his unique skills to the media industry. From record labels to music studios, many execs are only reluctantly experimenting with technological change. Besides being concerned that piracy protections aren't strong enough, they're petrified of losing control since it's unclear how they'll make money in the new world. And Jobs is a polarizing figure. While the major music labels were excited by the possibilities opened up by Apple's iPod, they're now leery that Jobs has pulled a fast one. Apple reaps billions from selling its hit music player, but there are sparse profits from the songs being sold over the Net.

The Disney deal may help give Jobs some additional credibility in the media world. While he had a major stake in Pixar in the past, he now sits on the board of one of the biggest media companies in the country. That means he has a fiduciary responsibility to protect the company's assets, from *Desperate Housewives* to Mickey Mouse.

Iger's assets and Jobs' vision could prove a potent combination. They've already shown how they can experiment in new areas and then create enough consumer excitement that others are compelled to follow. After Iger agreed to put ABC's shows on iTunes for downloading to video iPods, the other major networks followed suit. The same day as the Disney-Pixar agreement, iTunes began offering short films from the early days of Mickey and Goofy. How long before protective movie studio

visited the site, triple the number the year before.

What could the future according to Jobs look like? For starters, no radical changes will occur overnight. Given Apple's power branding, it's easy to forget that Jobs hasn't typically been the one to pioneer new areas. Many MP3 players existed before the iPod, and Microsoft has been slogging away for years on PCs fit for the living room. Apple has taken the first step in this direction by adding the ability to control a Mac from a couch via the Apple Remote and FrontRow software.

Speculation is rife that Jobs will move Apple fully into the living room, and there's little reason he wouldn't. The most likely scenario is that Apple would build a version of its Mac mini

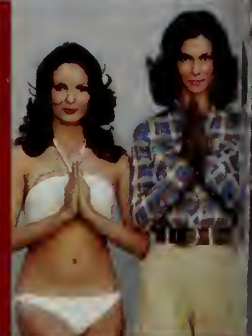
SECOND ACTS Pixar creative whiz Lasseter could revive Disney's animation studio

chiefs are digging through back catalogs in hopes of bringing extra revenues?

It's one more way which iTunes is evolving into something much more powerful than a simple music store. Besides songs, shows, and short films, it offers music videos and podcasts from national Public Radio independents like Bob Ibbott, creator of the cover song show *Charlie's*. In December alone, 20 million peo-

The Revolution Will Be Podcast

The Internet and digital technologies are remaking the world of media. With Apple's Jobs taking a seat on Disney's board, the two companies could lead the way.



UNLIMITED TV CHANNELS

Big and small producers are turning to the Web for alternative TV channels, new series online and up blogs and podcasts. TV characters and new Disney's ABC could just use Apple's iTunes to launch Net-only spin-offs of the 1970s' *Charlie's*.

be attached to a TV and entertainment center so the mini store family photographs and home videos along with ic and videos downloaded from iTunes. Taken to the extreme, the living room of 2010 may no longer need to have a rack, DVD player, TiVo, set-top box, or stereo. All those capabilities could be built into a single box, an Apple TV, or an e-branded home entertainment center.

ER, THE PEACEMAKER

N THERE'S THE WIRELESS-phone realm. Apple purchased the domain name iPhone.org years ago and in December trademarked the name Mobile Me. That may suggest it will produce a mobile phone or personal digital assistant to download songs over the air or sync up with a Mac or PC. The Disney-Pixar deal could open up all sorts of strategic opportunities for Disney and Iger if they can capitalize on Jobs' skills. For example, Disney could decide to push hard toward distrib-

vestors away. And while Eisner warred with Jobs, Iger worked hard to improve Disney's relationship. A key part of the reason for the Disney-Pixar deal, says Jobs, was "we got to know Bob."

Still, Jobs will be joining a Disney in short supply of its old pixie dust. As a board member, Jobs may argue for fast-tracking some of the digital distribution experiments Eisner discarded. Yet that could clash with Iger's ideas about how or how quickly Disney should proceed. A board showdown could prove difficult. Not only is Iger a new CEO, but he also was the second choice among at least some of Disney's 13 board members. (Some favored Meg Whitman, eBay Inc.'s CEO and a former Disney executive.)

Iger's worst nightmare may be that Jobs could sway so many Disney board members that he would win a wide-open race to become Disney chairman. Last year, with the board reportedly split between directors Gary L. Wilson and Robert W. Matschullat, former Senator George J. Mitchell was named interim chairman. He will remain as chairman until he retires at the end of 2006.

Jobs' success is based on the fundamental belief that a killer product will bring killer profits

g more of its content directly over the Internet rather than relying on cable companies or movie theaters. Iger has been the vocal voice in Hollywood on this score of late, even suggesting that new Disney movies should be released on the Internet the same day they hit the cinemas.

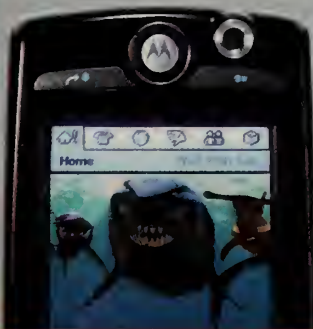
Since taking over from Eisner, Iger has shown himself will move quickly and take bold steps to remake the bureaucratic company he inherited. Among Iger's first decisions was dismantling the corporate strategic planning operation Eisner used to scuttle risky new plans. Iger patched things up with dissident former board members Roy E. Disney and Stanley Gold, who incited a shareholder revolt that kept large in-

Jobs has said he doesn't want the Disney top board job. Plus, that would complicate the potential conflicts of interest with Apple, as Disney makes more high-tech deals to distribute its content. Still, the mercurial new Disney board member could make a play to become chairman, say those with knowledge of Disney's board. "The problem then is that Bob would have a larger-than-life chairman to deal with only a year after a larger-than-life CEO was running his life," says one source close to Disney. "I can't imagine he's thrilled over that." Steve Jobs' arrival at the Magic Kingdom could have more thrills than a trip to Disneyland. ■

—With Heather Green in New York

ON DEMAND

W sells one-hour TV movies, perhaps even coming *Cars*, will w. The Net is a massive video-on-demand service, giving Disney reach film audiences CEO Iger, already one at tech-savvy media pushing the company changing movie bits.



MICRO AUDIENCES RULE

To reach fragmenting audiences, more **targeted programming will appear online, on cell phones, and through digital videorecorders.** Expect channels featuring hours of footage about deep sea diving or behind-the-scenes shots of the filming of Pixar and Disney movies.

POLISH LESS, RELEASE MORE

With plummeting production and distribution costs, content isn't as expensive to make and has a shorter life span. Unpolished snippets of interviews, backstage filming, and animated shorts are released more quickly. One sure hit: ESPN could partner with **Los Angeles Lakers superstar Kobe Bryant** to do a video blog after each game.



DIY PROGRAMMING

The concepts of prime time or show lineups are becoming antiquated as people pick and choose when they watch or listen to programming. At the same time, **do-it-yourself entertainment is on the rise.** Many viewers want video tidbits they can play with or the ability to influence shows by posting their thoughts on blogs.



(LEFT) (CHARLIE'S ANGELS) ABC/PHOTOFEST; (CELL PHONE) NONE; (FINDING NEMO) WALT DISNEY/EVERETT COLLECTION; (REMOTE) R. KNOBLOCH/A. B./ZEEA/CORBIS; (CARS) WALT DISNEY/EVERETT COLLECTION; (BRYANT) KEN JAMES/UPI PHOTO

Cracking the Whip at Wyeth

R&D chief Robert Ruffolo imposed tough targets on scientists—and it's working

BY AMY BARRETT

WHEN ROBERT R. Ruffolo Jr. signed on at Wyeth in 2000, his mandate was simple: shake up the drugmaker's mediocre research-and-development operation.

He has certainly succeeded. One of Ruffolo's first moves as executive vice-president of R&D was to conduct a top-to-bottom review of the company's pipeline. As the date of the meeting loomed, Wyeth researcher Steven J. Projan all but gave up sleeping. For five straight days, Projan was so worried about the survival of a novel antibiotic he'd worked on for seven years that he slept on his boss's couch and showered in the company gym when he wasn't fine-tuning the presentation for the drug. "There was a lot of fear and loathing about going through that process," Projan says. "Everybody was convinced this was a tool to kill off their favorite project."

Since jumping ship at SmithKline Beecham PLC in 2000, Ruffolo, who became president of R&D in mid-2002, has ripped apart and reassembled Wyeth's \$2.7 billion research operation. Among the 55-year-old executive's controversial changes: quotas for how many compounds must be churned out by company scientists. For some of them, that change seemed anathema to the complex and at times serendipitous drug-development process. But Ruffolo held bonuses hostage to meeting those goals. More recently he's been studying industries from aerospace to computer hardware manufacturing in a bid to bring greater efficiency to the innovation process.

Wyeth's efforts to energize its labs reflect a major challenge for drugmakers. In recent years Big Pharma's R&D output has been almost universally disappointing. According to the Tufts Center for the Study of Drug Development, only 58 new drugs were approved by the Food & Drug Administration from 2002 to 2004, down 47% from the peak of 110 from 1996 to 1998. The reasons are myriad, including a wealth of good treatments already available for many diseases and increased vigilance from regulators and physicians on safety. But with financial pressures building as more drugs go off-patent and as payers resist rising drug costs, Big Pharma can't afford to battle that problem by simply throwing more bucks at research.

On the surface, Ruffolo may seem an unlikely radical. He spent 17 years as a researcher at SmithKline Beecham before it merged with Glaxo. But he's hardly the typical cerebral scientist. He loves bands like Megadeth and Metallica. In his free time, Ruffolo, who lives in Spring City, Pa., with his wife and three kids, practices electric guitar in a basement complete with blacklight posters and lava lamp. "It's a 14-year-old boy's fantasy," he says.

PLAYBOOK: BEST-PRACTICE IDEAS

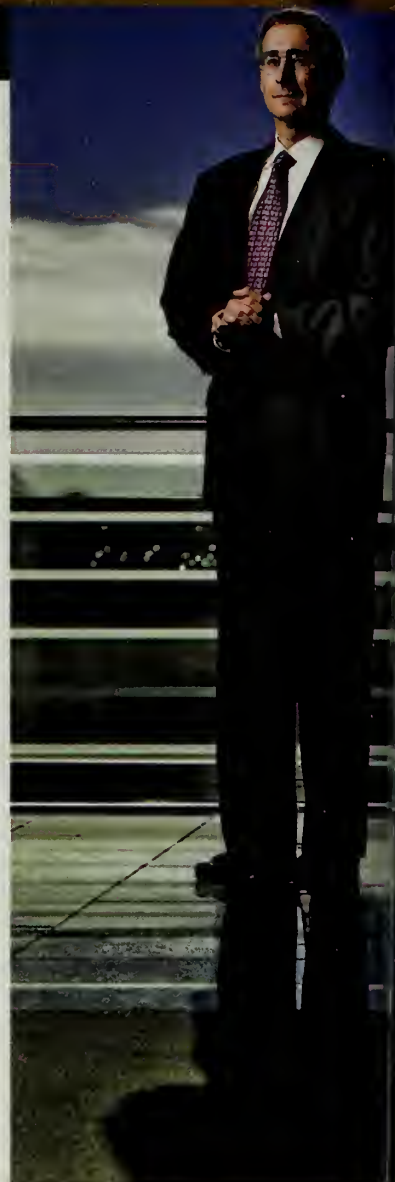
Going Outside To See How Others Manage Innovation

To marry creativity with efficiency, Ruffolo is taking lessons from non-pharma industries.

AEROSPACE

LESSON Complex projects require management skills at each stage of development

APPLICATION Wyeth wants to ide managers with superb scientific i early development projects and c with operational expertise to over late-stage clinical trials





RUFFOLO
"I think you
can manage
the outcome
[of] creative
effort"

determined for every project in the line based on factors such as the cost of developing it, the likelihood of success, expected sales. That culminates in an internal review that determines which projects move forward. The new rigor made it easier to halt troubled projects—critical improvement since late-stage human trials are so expensive. Brenda Reis, an assistant vice-president in Wyeth R&D, had to make one of

those tough calls. In early 2004 her group was developing a new oral contraceptive. As part of the portfolio-review process the team determined what sort of safety and effectiveness the drug would need to be a hit. In late summer, Reis recalls the 12 people leading the project sitting in stunned silence as they digested disappointing data from mid-stage human testing of the drug. A few weeks later they recommended nixing it. That earned the team an internal award—a clear signal that good decision-making would be rewarded at Wyeth.

MORE DISCOVERY

RUFFOLO HAS SET firm targets for how many compounds must move forward at each stage of the development process. Take discovery scientists, who identify new ways to attack diseases and create compounds worthy of more extensive testing. When Ruffolo came in, that group was moving four drug candidates out of its labs every year. Ruffolo ordered them to up that to 12—with no increase in resources. The target has been met every year. The goal was upped this year to 15.

The targets forced big changes. For one thing, scientists needed to standardize more of what they did to move compounds along more quickly. At the old Wyeth, researchers could design early human safety studies in almost any way they wanted. Now researchers pick from four or five standardized formats. That helped cut trial periods from 18 months to 6.

The approach has its critics. William J. Weiss, who left Wyeth in early 2004 and is director of drug evaluation at biotech Cumbre Inc. in Dallas, says quotas like Ruffolo's can prompt scientists to "overlook problems with some compounds" to make their numbers. And Wyeth has seen a higher failure rate in midstage testing. Ruffolo says that's the case throughout the

Critics say quotas pressure researchers to overlook problems

industry. Still, even supporters, such as C. Richard Lyttle, CEO at pharmaceutical company Radius Health Inc. in Cambridge, Mass., say those pressures can also force people to zero in on the projects that are the safest bets. "You don't get the real innovation," says Lyttle.

Ruffolo dismisses such criticisms and says Wyeth took steps to ensure that

only high-quality compounds advance. For example, while discovery researchers used to have great control over what went on to human testing, a council of scientists, regulatory experts, and marketing execs now make the call. So scientists can't simply pass a few questionable drugs out of their labs to meet targets. Ruffolo deliberately put fewer controls in at the exploratory phase, when scientists tend to have eureka moments. "I don't think you can manage creativity," he says. "But I think you can manage the outcome after you have that creative effort."

Has Ruffolo's prescription worked? UBS Investment Research analyst Carl Seiden says Wyeth's pipeline is much improved, with a number of potentially hot products likely in the next few years. Among them: a new antidepressant based on its current blockbuster Effexor. Citigroup estimates that Wyeth will get 20% of revenues from new products in 2009, nearly double the industry average.

The hunt for productivity boosts continues. Clinical trials, for example, are longer and costlier than ever. So last year he asked Dr. Evan Loh, vice-president of Wyeth's clinical R&D, to come up with a new blueprint for human testing. Loh's team visited companies in a range of industries, studying everything from how they manage complex projects to how they streamline manufacturing (table). The experience will help "fundamentally change how we do things," says Loh.

Ruffolo is borrowing from software programming with a move toward global task-sharing. When the lights go out in, say, Collegeville, Pa., some tasks will be handed off to labs in other time zones. Steve Projan is already planning how to share work with a lab in Dublin, Ireland. But he's the first to concede that this sort of thinking takes getting used to. "Scientists love working in silos," he says. "We are all prima donnas." ■

RIGHT SHIPPING

The standardization of processes can lead to far greater speed and accountability.

ON Rather than leave the handling of critical materials, from blood samples, in the hands of others, Wyeth will partner with a shipping company

COMPUTER MAKERS

LESSON Computer makers use process engineers to identify the most efficient way to make a new product

APPLICATION Wyeth plans to hire process engineers from nonpharma businesses to evaluate some steps in its drug development procedure, including how a potential new product is moved from research to human testing

BusinessWeek online For more on how Ruffolo is remaking Wyeth's R&D operation, go to businessweek.com/extras



Four Men In a Sneaker

Buddy story: How Finish Line became the No. 2 athletic shoe retailer

BY ROBERT BERNER

HOW DO FOUR GUYS CREATE a \$1.3 billion business over nearly 25 years and still remain best friends? Ask the founders of Finish Line Inc., who have built the nation's second-largest athletic shoe retailer. (Foot Locker Inc. is No. 1.) "We would yell and scream, but we never brought it back to the office the next day," says Chief Executive Alan H. Cohen. "It was almost like we were brothers."

Success like Finish Line's will smooth over a lot of rifts. Annual earnings growth of 53% over the past three years helped land the Indianapolis-based footwear chain a spot at No. 66 on *BusinessWeek's* Hot Growth list of the fastest-growing small companies. But Cohen and his buddies must find a second wind, as Finish Line's pace has flagged of late. For the fiscal year ending this February, the company is forecasting that sales at stores open at least a year will rise just 1% or so, compared with 8.6% the prior year. (Same-store sales would be flat or down slightly if

Internet purchases were not included.) As for profits, they'll be flat, at around \$61 million. Finish Line's stock is off 34% from March highs, to about 17.20 a share.

Like rival sport shoe chains, Finish Line has suffered from the lack of a hot

COHEN Fashion sneakers are undercutting his sports lines

new sneal models to dr customers in stores. The popularity of fa

ion sneakers like Puma has a crimped sales because those sel lower prices than basketball or r ning shoes and are sold through variety of outlets, including depe ment stores. Finish Line's outloo also clouded by its impend launch of Paiva, a new chain t offers upscale athletic apparel women, and its year-ago acqui tion of the 49-store hip-hop app el chain Man Alive. The move to ban apparel is outside Finish Li expertise, says J.P. Morgan ana

Robert Samuels, and "it adds more fa ion risk to the business."

Cohen, however, contends that the new ventures will help power future earnings growth. He adds that he "fully expects to see a recovery," in the performance of the Finish Line outlets. It tainly won't be the first time this 58-y old Indianapolis native has had to down the skeptics. In 1976, fledg lawyer Cohen teamed up with two frie David Klapper and John Domant, contributed \$20,000 apiece for the ri to open Athlete's Foot franchises in I ana. Their agreement covered only Hoosier State, so in 1982, as they were ning out of mall space for new Athl Foot stores in Indiana, the group cam with the idea for Finish Line, original outlet-type concept. Once their licen

HOT GROWTH COMPANY

BIO

Alan H. Cohen

A Hoosier finds his niche not far from the basketball court



Data: BusinessWeek

BORN Mar. 5, 1947, in Indianapolis
POSITION Chief executive and chairman of Finish Line Inc. since 1992.

EDUCATION BS in marketing, Indiana University, 1969; JD, I.U. School of Law, 1973.

HOOP DREAMS Although 5'9", he won a basketball scholarship to Abraham Baldwin Agricultural College in Tifton, Ga. Left after a year on his father's advice: "You can't eat a basketball."

MOONLIGHTING He joined his dad's law firm, but on the side, i 1976, bought the franchise right to open Athlete's Foot stores in Indiana. By 1980 he had left law practice to work full-time in the sneaker business.

FAMILY Wife, Linda; son, Nath: 28; and daughter, Lauren, 25.

LAST BOOK READ *Eragon* and *Eldest*, two books in the *Inheritance* trilogy by Christop Polini.



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*Based on a 2005 Stratascopes Inc. analysis of publicly available fiscal results of all non-financial companies listed on NASDAQ and NYSE.

deal with Athlete's Foot expired in 1986, they converted those franchises into Finish Line stores, too. Cohen and Klapper (Domant, a silent partner, was bought out by 1992) brought on two other friends as partners: Larry Sablosky to run store operations and David Fagin as buyer for apparel.

PICKING A CAPTAIN

DESPITE THEIR SOLID track record with Athlete's Foot, Cohen says he initially had a hard time persuading mall developers to rent out space for Finish Line. Still, it steadily grew to about 100 stores around the country by the early 1990s. The \$100 million public offering in 1992 was yet another test of the men's friendship. Until then, the four had run

The four founders all got along by "setting ego aside"

the venture pretty much as equals. But to gain credibility with investors, they realized Finish Line needed a clear corporate hierarchy, with Cohen calling the shots. Klapper and Sablosky both settled for the title of executive vice-

president. Fagin eventually left. But all four remained close because, says Klapper, 57, everyone was good at "setting ego aside."

In spite of Finish Line's current travails, it remains a survivor in a crowded industry. Two of the four big players—Athlete's Foot Group Inc. and Footstar Inc., parent of the FOOTACTION and Just for Feet chains—have sought bankruptcy protection in recent years. Now, at 650 stores, Finish Line plays a strong No. 2 to 3,600-store Foot Locker by offering a broader array of merchandise. Finish Line's stores stock nearly twice as many sneaker styles—about 700 to 800 per store—and more athletic apparel. That makes major suppliers such as Nike Inc. and adidas-Salomon happy. "They show a broader range of our products," says Erich Stamminger, CEO of adidas' North American operations. "It's a win for both of us."

Sneaker styles may come and go, but Cohen, Klapper, Sablosky, and Fagin still have their friendship. Cohen's wife, Linda, says the group has spent so much time together over the years they are far more than pals. "It feels more like a family relationship than any other friendships we have," she says. ■



Qwest Isn't as Hale as It Looks

The Bell is back from the brink. But its cash flow could come under pressure

BY ROBEN FARZAD

FOUR YEARS AGO, QWEST Communications International Inc. was on bankruptcy's doorstep, its shares fetching just a buck apiece. The company was saddled with a \$26 billion debt load, was en route to posting a \$35 billion loss, and was being swarmed by regulators looking into its accounting practices and allegations of insider trading.

Yet in the past year, shares of the Denver-based telco have soared 31%, to 5.90, trouncing the average 3% return of its fellow Bells and the 11% return for the Standard & Poor's 500-stock index. Investors have rewarded the company for its U-turn from negative free cash flow of \$400 million in 2002 to a positive estimate of \$1 billion to \$1.3 billion in 2006.

And with Chief Executive Richard Notebaert recently hinting that Q might soon post an actual profit, investors are betting that management will throw off a chunk of that newfound cash to shareholders as a dividend. Qwest currently pays nothing, while the other Bells—Verizon, the newly merged AT&T and BellSouth—boast an average dividend yield of 5%. Says CFO Ore Schaffer: "I think we can sustain our model and continue to generate free cash flow that we can return to shareholders."

Investors shouldn't expect to see a check in the mail just yet. Some analysts say Qwest's financial situation isn't as solid as Schaffer and bullish investors think, and that its vaunted flow improvements might be near the end. In fact, the financial picture could get cloudy again—and soon.

After the recent run-up, Qwest now trades at a premium to its larger, richer peers (table). Because telecommunications is a capital-intensive business that requires huge amounts of debt—and interest payments—the price-equity ratio isn't an especially useful investing gauge. Analysts weigh the Bells based on their enterprise value (EV), or market capitalization plus debt, minus cash and equivalents, divided by their earnings before interest, taxes, depreciation, and amortization (EBITDA). According to Standard & Poor's

research, Qwest's EV/EBITDA multiple of 6.1, compared with the other Bells' average of 4.7.

at 30% premium reflects Qwest's exposed position as a rurally entrenched carrier, says Viktor Shvets, a telecom analyst for Deutsche Bank Securities Inc. Its customers, spread over a 14-state area that includes New Mexico, Nebraska and the Dakotas, are thought to be less likely to flee than, say, Verizon's landline customers in the Northeast, who have the incentive to sign up for the bundled cable television offered by the likes of Cablevision Systems Corp. and Time Warner Cable. Qwest's annual customer defection rate of 4.8% trails the average of 5.5% sustained by Verizon, BellSouth, and AT&T.

SO RURAL

RELATIVE STABILITY means Qwest doesn't have to ramp up its capital spending as aggressively to compete with rivals, says the thinking goes. According to Deutsche Bank, Qwest's landline business boasts a capital spending to sales ratio of 13%, vs. nearly 22% for Verizon,

18% for BellSouth, and 14% for AT&T. "Our region does have a lot of rural areas," says CFO Shaffer. "These customers are very stable.... Cable companies would rather invest in dense areas. They're not prepared for a rollout [to rural areas]."

Perhaps. But a close look at the concentration of Qwest customers belies the rural claim, says Deutsche Bank's Shvets. At the end of 2004, he notes, the Federal Communications Commission clocked Qwest at about 10,000 access lines per switch. (Think of a hub and spoke system, with many lines flowing into one switch.) That 10,000 wasn't far behind AT&T and BellSouth and was actually 20% more than Verizon's density. The true rural carriers, meanwhile, showed line densities of just 500 to 3,000. Shvets found that five states—Arizona, Colorado, Washington, Minnesota, and Oregon—represent two-thirds of Qwest's access lines and more than 80% of its local line revenue. His conclusion: "Qwest is not a rural carrier."

The more densely populated the area, the more competition from cable and wireless players. As a result, says Shvets, "you need to assume that Qwest's free cash flow will decline" in the future as competition and customer churn increase. For that reason, Shvets downgraded the stock to "sell" from "hold" on Jan. 17.

Standard & Poor's equity analyst Todd Rosenbluth agrees. "Denver, Seattle, and Phoenix are not small rural markets," he says. "We think [Qwest is] going to have to spend more to compete." Rosenbluth has a "sell" rating on Qwest, which is trading at a 30% premium to his 12-month price target.

One area where Qwest can't compete is in wireless service. Unlike all three of its Bell rivals, Qwest doesn't have a wireless unit to absorb its landline defections. When customers ask for wireless, Qwest can only resell them Sprint Nextel Corp.'s

service, hardly a recipe for future subscriber growth.

The carrier lacks another cash-flow cushion: a telephone directories business. In 2002, with its back to the wall, Qwest sold its directory publishing operation to a private equity consortium for \$7.05 billion to help pare its then-\$26.5 billion debt load. The move helped Qwest to slash its debt to the current \$14 billion. But Qwest-Dex was a cash cow, helping the company ride out business slumps. No longer.

And \$14 billion is still a ton of debt, so much so that Qwest has little margin for error, say analysts. S&P's Rosenbluth points out that Qwest's total debt still stands at nearly six times its EBITDA, while the regional Bells' are closer to two times. That means Qwest's interest expenses are still disproportionately burdensome, making it all the more difficult to generate free cash.

Put all of these factors together, and Qwest could see its free cash flow drop from the \$1 billion-plus expected this year to \$500 million to \$700 million in the next three years, estimates Shvets. That wouldn't bode well for a stock price buoyed by supposedly improving cash flow.

Give management credit for acting to improve Qwest's balance sheet instead of seeking bankruptcy protection, as had many telecom companies that binged on debt in the late

1990s. Its savvy moves have paid off. In November, for example, Qwest raised \$2.9 billion to fund a debt tender offer, the third in two years, that will slash its annual interest expense by \$350 million. "We worked our way back from the brink of insolvency without wiping out shareholders," says CFO Shaffer. "You couldn't be any flatter on our backs than we were."

True enough, but Qwest still has a ways to go on the road to redemption. "What they've done in reining in losses and refinancing debt has been great," says Shvets. "Now for the hard part." ■

The carrier has no wireless unit to absorb landline defections

So Far, So Fast?

Qwest's stock has outperformed its peers handsily during the past year. But by some important investing measures, the company still lags.

	52-WEEK STOCK PERFORMANCE %	EV* EBITDA	TOTAL DEBT/ EBITDA	PRICE/EARNINGS RATIO**	DIVIDEND YIELD %
AT&T	5	4.6	2	13	5.44
BellSouth	5	5.1	2.3	14	4.33
Qwest	31	6.1	5.9	n/a	n/a
Verizon	-11	4.6	1.45	12	5.24

*Enterprise value/earnings before interest, taxes, depreciation and amortization **Based on 2006 earnings estimates

Data: Standard & Poor's, Bloomberg



INNOVATIVE For a decade, Gilbert's picks beat the S&P 500

Hedging Bets In Harrisburg

Underfunded state pensions are taking cues from Peter Gilbert's daring investments

BY NANETTE BYRNES

THE INVESTMENTS THAT a parade of Wall Streeters pitched to Pennsylvania's state pension officials one recent morning included some surprisingly exotic and risky offerings. Having traveled from New York, California, and points in between to make 10-minute sales presentations in Harrisburg, the sharp-suited men and women suggested

everything from real estate deals to venture capital funds and an early-stage drug development venture.

Their audience: the 11 politically appointed members of the board of the Pennsylvania State Employees' Retirement System who ultimately choose its investments. The man who had orchestrated those sales pitches—and who has steered the board toward an unusually aggressive investment strategy—is Peter Gilbert, the \$27 billion fund's nonvoting

chief investment officer. He is an unlikely star in the traditionally staid world of public pensions.

With a master's degree in social work and investment savvy gained on the job while overseeing pension funds in New York City in the 1980s, Gilbert has averaged annual returns of 10% over the past decade. That's better than the Standard & Poor's 500-stock index and results achieved by most other state pension funds, including CalPERS in California, the nation's largest, with \$159 billion in assets. Pennsylvania, which is No. 22 in assets among statewide pension funds, has accumulated this strong record with a complex mix of stocks, bonds, private equity partnerships, and—perhaps the eye-catching of all—hedge funds. 23% of Pennsylvania's assets are in hedge funds, a level unmatched among public plans for state workers.

Gilbert's success has helped fuel a frenzy of interest in hedge funds among public plans that once stuck to safe, vanilla investments. According to consulting firm Greenwich Associates, 17 public plans are already investing in hedge funds—lightly regulated and

secretive investment pools—and 49% expect to increase their hedge fund holdings in the next three years. J. Tomilson, vice-chairman of Blackstone Group, which runs a fund that invests in hedge funds for clients including Pennsylvania, estimates that within a few years, public pension plans, now the source of 25% of assets, will account for 40%. It's part of a push by the plans into complex, less-risky investments, which can also be less risky, and away from traditional fixed-income and stock investments.

Some observers worry that the pension plans will become more vulnerable to unexpected, unanticipated losses. Even for asset managers who avoid hedge funds, funds such as Bayou Management LLC and Wood River Capital Management, the hefty fees and lack of disclosure make the funds a tough investment to win. Says Theodore R. Aronson, a partner at Aronson+Johnson+Ortiz, a Philadelphia institutional investment manager that runs hedge funds as well as traditional investment accounts. "The plan is stacked against you" because of the fees, he argues. While "in the rest of the capital markets [performance] information is verifiable, no one monitors this fund crap."

LS RUSH IN?

GILBERT ACKNOWLEDGES there are dangers. "You have to first understand why you want to use them," he says. "not get in because it's the next hot thing. I think a lot of people will be disappointed. A lot are coming in who probably shouldn't be."

For Gilbert's admirers, including those who see little reason to worry about performance. "He knows what he's doing," says Bob Maynard, chief investment officer of Idaho's public pension plan, which is up 9% in the past year. Gilbert says he has little choice but to chase for high returns. Like many other public pension plans, including Idaho's and California's, Pennsylvania's is underfunded.

Because Pennsylvania's workforce isn't growing, the plan covers almost as many retirees as it does employees. It takes roughly \$400 million a year to pay an employee and state contributions but pays out more than \$2 billion annually in benefits. The fund's assets are currently \$1 billion less than the estimate of what will be needed in

coming decades. And that discrepancy assumes that Gilbert's investments pump out returns of 8.5% per year.

Gilbert isn't one to admit to feeling a great deal of pressure from the shortfall. But when the pension plan's assets dropped with the market downturn of 2001-02, he certainly felt the heat. "It was brutal," he says of the criticism in the press and elsewhere. "They all asked: 'How could you lose all that money?' But no one looks at what happened to the fund before that." Just as frustrating for him has been the myopic tendency of the legislature to shortchange the plan. "You have a lot of politicians and administrators out there who don't plan very well," he complains.

Political decisions beyond his control have made Gilbert's job far more challenging. In 2001, Pennsylvania lawmakers increased their pensions by 50% and simultaneously raised other state employees' benefits almost as much. At that time, the pension fund was still comfortably in the black, thanks to generous returns from the long bull market. But big bills are coming due. By 2015, the plan's annual obligations are expected to grow to \$4.4 billion. Meanwhile, the state continues to contribute only 2% of workers' annual salaries—way below the actual cost of benefits. In 2012, the state contribution is supposed to jump suddenly to 23.5%, but it's entirely unclear where Pennsylvania will find that huge wad of cash.

These demands almost compel Gilbert to push for results exceeding those of the stock market, which in 2005 returned 5%, using the S&P 500-stock index as a gauge. Gilbert's numbers have been so good that in recent years he has been hailed by industry groups. In October, *Institutional Investor* magazine named him the nation's top public pension plan manager.

In addition to putting nearly a quarter of the Pennsylvania plan's money into hedge funds, Gilbert has allotted 6.8% for real estate, 12.3% for private equity and venture capital, and 20.8% to international stocks. That mix looks a lot like that of the endowments of Yale and Harvard Universities, which moved toward "alternative" investments, with great suc-

cess, back in the 1990s. Robert A. Bittenbender, a member of Pennsylvania's board, says, "You have to get comfortable with the fact that our individual working knowledge might not be at the same level it was when we were just talking domestic equities and domestic fixed income."

Gilbert, who has a professional staff of 13, first invested in hedge funds in 1999. By 2002 he had switched strategies. Instead of directly investing in the funds,



TROOPERS
More retirees to support

Penn's Stake

The Pennsylvania State Employees' Retirement System has invested in 245 hedge funds through these four "funds of funds":

- Blackstone Alternative Asset Management
- PAAMCO Absolute Return
- Mesriow Absolute Return
- Morgan Stanley Alternative Investment Partners

he increased his hedge fund allocation but began directing money toward funds that invest in multiple hedge funds. This approach provides more diversification and, in theory, more sophisticated monitoring by experts at the funds of funds. He coupled this with the purchase of options on the broader market, a technique that gives him the chance to benefit from a market climb but is less risky in an equity meltdown. Gilbert says that since he took this approach in 2002, the combination has added more than \$500 million in earnings to the state plan. In 2005, however, the stars of his portfolio were other alternative investments, particularly real estate and private-equity funds.

All of which is highly expensive. In 2004, Pennsylvania paid \$195 million in advisory fees, up from less than \$80 million in 1998. Says Gilbert: "Sometimes you have to pay for what you get." ■

THE STAT

23%

The portion of Pennsylvania's plan invested in hedge funds.

Data: Pennsylvania State Employees' Retirement System

What's Raining On Solar's Parade

Almost all solar panels are made with silicon—and makers can't buy enough of it

BY JOHN CAREY

SOMETIMES IT'S POSSIBLE to be a little too successful. The solar power industry has been on a tear, growing at more than 30% per year for the last six years. It's poised to reach a surprising milestone within two years, when it will gobble up more silicon for its electricity-generating panels than semiconductor makers use in all their chips and devices. The onetime "tree-hugger" industry is not a niche business anymore," says Lisa Frantzis, director of renewable energy at Navigant Consulting Inc.

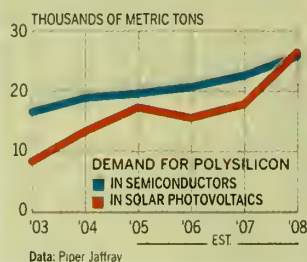
So what's the problem? "Global demand is stronger than the existing supply," says Lee Edwards, president and CEO of BP Solar. His company and others can't buy enough of the ultrapure polysilicon now used in 91% of solar panels. The raw material shortage has slashed growth for the industry from more than 50% in 2004 to a projected 5% in 2006.

The shortage has caused prices for polysilicon to more than double over the last two years. As Economics 101 teaches, that should prompt producers to expand capacity. But for suppliers such as Michigan-based Hemlock Semiconductor Corp., the world's largest producer, the decision hasn't been easy. For one thing, the company was badly burned in 1998. It had just built a new facility in response to pleas from semiconductor makers when Asia went into a slowdown. Demand for silicon plunged, and the factory had to be



WHO USES SILICON?

Chips still consume the most, but solar panels are growing



shuttered. Now the U.S., Germany, and other nations are offering subsidies for solar power—but governments can take away incentives as easily as they put them in place. "We did a lot of soul-searching," says Hemlock President and CEO Donald E. Pfuehler. "Would the incentives go away? Is the solar industry real or just a flash in the pan?"

Hemlock finally decided that the industry is real, but only after solar companies agreed to share the risk by signing contracts to buy the future output. So in December the company began an expansion worth more than \$400 million that will increase silicon production by 50%. Competitors are following suit. On Jan.

12, Munich-based Wacker started construction on a silicon manufacturing plant. The new supply, however, won't be onstream until 2008.

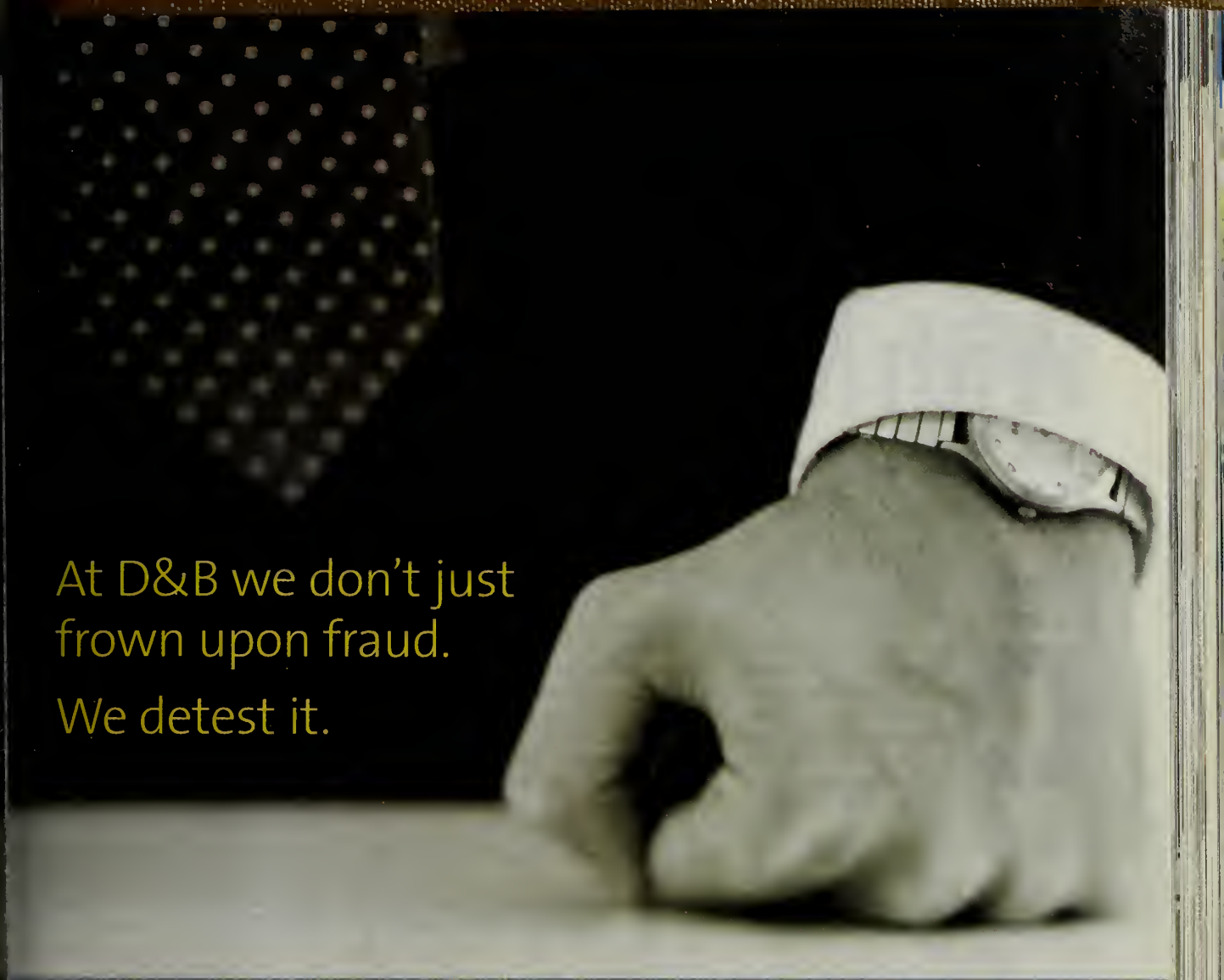
A JOLT FROM SUBSIDIES

IN THE MEANTIME, companies are scrambling to cope with the shortage. Sharp Corp., the world's top producer of solar panels, and BP Solar are making panels thinner to use less silicon. First Solar LLC in Phoenix and others are ramping up nonsilicon technologies. "This is a perfect sector for innovation and new players," says BP's Edwards.

One factor driving demand is China's scheme of paying big bucks (more than 55¢ per kilowatt hour) for power from anyone with solar panels. That "lucrative program came out of all by surprise and gave us a lot of push," says Pfuehler. Spain and Italy have jumped in with similar plans. In the U.S., the 2005 energy bill included subsidies, and "governors are going nuts on renewables," says Scott Sklar, president of Stella Group Ltd., a green power consultancy. "The funny thing he adds, "is that Republican governors, like California's Arnold Schwarzenegger and New York's George Pataki, sound crazier than Al Gore on this." The most ambitious plan came on Jan. 12, when the California Public Utilities Commission marked \$2.9 billion over the next years for solar power.

For many nations, solar power offers a hedge against spiking prices of fossil fuel. In Japan, even without incentives, high fuel prices and other factors have made solar electricity almost competitive. And huge potential markets, such as China, are just beginning to be tapped.

That's why analysts predict the growth will surge when the new polysilicon production lines get going. And the industry should continue for at least 10 years, then, technological improvements, economies of scale, and competition from new entrants such as China may make sun power cost-effective without government help. "Prices are going down this year, and the cost of standard electricity is going up," explains Ron Kenedi, vice-president for solar energy solutions. "There will be a meeting point." That happens, the industry may find growth without growing pains. ■



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Decide with Confidence

Getting Creative With Mad Ave

To find the right agency, MINI Cooper devised a quirky trial-by-immersion

BY DAVID KILEY

ON DEC. 21, MINI USA Chief Jim McDowell stood before about 20 members of his executive team, plus five members of his newly hired ad agency at the carmaker's New Jersey headquarters, going over critical plans for the coming year. Changes to the Web site, a new ad campaign, and a huge dealer meeting in Detroit the second week of January meant working the holiday week. Everyone was keyed up. But McDowell wasn't fazed. Donning an apron in a conference room equipped with electric frying pans and a buffet table, the 54-year-old orchestrated

the morning work session as he made everyone omelettes and home fries. "Cooking relaxes me," he said, grinning.

When McDowell took over MINI last April, the U.S. unit of Germany's BMW was firing on all cylinders. Sales surpassed targets by a mile, and rival carmakers pointed to its marketing campaign, using very few TV ads, as a "buzz" marketing benchmark. Then in September, MINI's celebrated ad agency, Miami-based Crispin, Porter + Bogusky, abruptly resigned the \$30 million account to take on the \$400 million Volkswagen assignment. This was no small challenge for McDowell, who had migrated from MINI's sister company, BMW of North America LLC, where he earned industry

accolades for developing the groundbreaking BMW film series on the TV. This time, rather than choose an agency via the routine process, McDowell decided to upend the entire exercise.

What emerged is an approach that offers valuable lessons for other executives grappling with brand strategy. Companies are challenged more than ever to find their marketing right, and the stakes are high. Some of the biggest advertisers, such as General Motors, Ford, and Coca-Cola, have traced recent woes to failures of brand management and have been courting new agencies to help them rebound. But for all the billions spent on ads, the process by which an agency is selected has seen most no new thinking until now. McDowell found a way to test not just agencies' marketing flair but also the personal chemistry between agency and client. The key, experts say, to a successful long-term relationship.

MINI started out following a standard script, up to a point. McDowell's move was to hire Raleigh (N.C.)-based consultant Hasan Ramusevic, who handles a dozen ad agency searches a year. Ramusevic began with 50 candidates. MINI whittled them down to eight, inviting them to answer long questionnaires and visit headquarters. Of those, three were selected for a rigorous trial process that would last two months.

The first deviation from the norm came when McDowell organized a "boot camp" for the four finalists: a weekend immersion into all things MINI at a Rye Island (N.Y.) hotel. There was plenty of face-to-face and driving but the agencies were also required to perform in front of one another as each tried to impress the client with an unheard-of concept in the notoriously competitive ad world. "You don't tell the client in these situations to blurt out

The Road Less Traveled



LABOR DAY WEEKEND, 2005

Jim McDowell, head of MINI USA, hears rumors that his agency, Crispin, Porter + Bogusky, is going to be tapped to take over the Volkswagen account. He sends an e-mail to CP+B Chairman Chuck Porter asking if the agency is "committed to MINI long term." Five days go by without a response.

SEPT. 6 CP+B resigns from MINI to take over the VW account.



...that's what they want us for," says Goodson, president of Strawberry Frog, one of the four contenders. First, each team had to introduce themselves and create interesting name tags on the spot. The team from New York-based Mother put pictures of their actual mother on the name tags. Butler, Shine, Stern & Partners (BSSS) of Sausalito, Calif., in a nod to so-called correct recycling and frugality, they used recycled, reused plain name tags from a previous week.

NY DAY CAPER

ON EACH TEAM took turns answering questions that tested improv skills. "If Arnold Schwarzenegger runs for President, who should be his running mate?" was one game question. (Strawberry Frog's team was divided between Sylvester Stallone and Papa Smurf.) They also were sent out into nasty weather to drive MINI Coopers and go on a kind of scavenger hunt for ideas and props to be used for a scrapbook. The teams would tell a MINI story that they created, and the client would all review the stories over cocktails. Butler Shine's scrapbook was based on a story about a mannequin team named Darlene, which it stole from a local electronics store. The team and team motored in a MINI to a parking lot, but the caper ended up, well, with the team being grilled at the local police station. "It was unusual to get up with your competitors, but be small and independent, we are all members of the same club," said BSSS Creative Director Michael Shine. Only one agency quit after boot camp. Sometimes we don't feel the chemistry," says San Francisco-based Venables Bell & Partners founder Paul Venables—something he sensed when giving a MINI especially hard on the roads with a tense McDowell in the

car. But Venables nonetheless liked the process. "Most pitches boil down to a three-hour presentation where you feel like a trained monkey, and all the stuff you know and have ever learned doesn't matter," he says.

To McDowell, the point was to get closer to how each agency thought, behaved, and went about their business when unexpected situations were thrown at them. All three shops, too, had regular access to the MINI team, via phone, e-mail, and visits. McDowell scrapped a common practice, maddening to agencies, of a company sharing every bit of information requested by one agency with all the contenders to keep the playing field level.

It's not uncommon, says Ramusevic, for relationships between a marketer and a new agency to hit the rocks in less than two years for having failed to bond earlier. So over the two-month-long shootout, says MINI marketing manager Trudy Hardy, the carmaker treated each agency as if it were already working on the brand. The open access helped the ad folks toss around marketing ideas that might have been duds in a final presentation. One of the winning ideas: to open up MINI's on-

MINI wanted to see how each agency handled the unexpected

line lounge, a popular gathering place for owners, to prospective buyers for a few weeks to help suck them into what McDowell calls the "MINI mindset."

On the final day of boot camp, Butler Shine CEO Greg Stern and his partners showed a film that staffers had created driving a MINI on historic Route 66 and uploaded to the Internet—but

which Stern hadn't previewed before showing it to the MINI team. "I wasn't worried that it wouldn't be good," says Stern. Countered McDowell: "I thought that took nerve."

In the end, McDowell gave the account to Butler. He especially liked its work for Converse sneakers, including a campaign in which Converse enthusiasts, rather than hired hands, created short Internet films, which also ran on TV.

All the good vibes aside, the fruits of the MINI process won't be revealed until the first campaign gets off the ground this spring. Butler Shine has a tough act to follow in Crispin Porter, which in essence fired its client, a rarity in the ad business. Still, even if the new marriage doesn't last, the two parties get credit for helping to reinvent the way companies and ad agencies go a-courtin'. ■

OCT. 6 MINI chooses four agencies: Butler, Shine, Stern of Sausalito, Calif.; Mother, New York; Strawberry Frog, New York; and Venables, Bell & Partners, San Francisco.



DEC. 8 A public Webcast announcement of the new agency, Butler Shine, is made from a bait and tackle shop in Sausalito.

OCT. 14-16 Executives from the four agencies selected attend a MINI boot camp in Rye Brook, N.Y. The contenders drove MINIs, went on a sort of scavenger hunt, stole a mannequin, and were immersed in all things MINI.

JAN. 9 MINI announces at the Detroit Auto Show that it will build the MINI Traveller sport wagon in 2008.



Crunched By the Number

Nagging fears of a destitute retirement led this "downshifter" to rethink his life. **BY LEE EISENBERG**

MOST OF US APPROACH retirement planning in one of two ways. Some of us, not many, make like the Little Red Hen: We run and rerun the numbers, weigh the myriad risks of inflation and projected market returns, and put contingencies in place to finance longer-than-expected lives. The rest of us play financial chicken. Procrastinators to the max, we plant precious little grain, even though we know the second half requires a great deal of bread.

Me, I was one of those procrastinators. Through my 20s, 30s, and 40s, I contributed to the retirement plan at work; that was pretty much it. My investment mix was tepid: heavy on bonds,

light on stocks—who could forget Black Monday? Not once did I seek systematic counsel from a financial adviser; I had no detailed road map to the future. Then, seven years ago, things took a turn. At the time my wife and I—46 and 52, respectively—and our two kids (still in grade school) were leading the sort of life we'd convinced ourselves we wanted. We were downshifting, as it's trendily called these days. We lived in a nice enough house in Westchester County, just 30 minutes from Grand Central. Three days a week I rode the train into Manhattan, where I had a pleasant, if not especially remunerative, consulting deal at Time Inc. The

other days I played bad golf with retirees who were a good 20 years my senior.

Could I afford this mellow middle passage? Who knew? Every now and then a pang hit, such as whenever I wrote out a fat property tax check. Or when the slightest intimation of mortality—was that a flicker of heartburn or the onset of a full-fledged cardiac infarction?—foretold the prospect of financial unraveling or worse. One Zantac and five minutes later, however, and I was downshifting again at the driving range.

Those intermittent pangs melded into a giant Pang Attack one gray January afternoon. The phone rang. It was a job of-

fer. The caller was the vice-chairman of Lands' End, then a \$2 billion public company. Unaware that my ad hoc retirement plan called for three decades of retirement, he asked if I'd have any interest in overseeing the company's creative and marketing operations—report CEO, be a corporate big shot. A may fan, he explained that the Lands' End catalogs needed more sizzle, the kind of stories and features you'd more find in national magazines than in a catalog. The job, he said, carried a generous salary and bonus, plus stock options, the grain of choice in the late

Lands' End, he said, was no flash



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CHANGE OF PLANS
A job offer from Lands' End ended Eisenberg's semiretirement

Unlike the eToys of the brave new e-world, the company had actual customers—10 million of them, all comfortable ordering by phone and soon, presumably, via computer. There was a wonderful culture in place and a loyal workforce that delivered the goods with amazing efficiency and friendliness. Finally, the vice-chairman said, trying to set a boxer briefs on fire, Lands' End was highly profitable, with a squeaky clean balance sheet. I was already halfway old, no matter that it all sounded like a half and that I couldn't just put it in. Lands' End, he reminded me at the end of the conversation, was based

in tiny Dodgeville, Wis. The deal, non-negotiable, was that we'd have to drag kids, dog, and middle-aged bones all the way to Badgerland.

On the train ride home that evening, I weighed the pros and cons. Actually, there were so many cons I never made it to the pros and nearly missed my stop. Downshifting? Forget about it. Aging parents? Friends? They'd be far, far away. Our

kids? They were happily settled—why mess with their heads? Wisconsin kids would all be hulking, fair-haired, hockey-playing Vikings. Our kids, on the other hand, displayed no incipient fondness for herring or dogsledding.

Trudging up the hill from the station, I finally got to some pros. The job carried lots of responsibility. It was a chance to revitalize an admired brand. Then the pangs hit hot and heavy. The image of me, in a nursing home, no one to swab my chin. My wife, a destitute widow. The kids, scrounging for tuition. Could we possibly turn down a promise of grain, which, if planted diligently, would make all the difference 10, 20, 30 years from now when our geriatric chickens came home to roost?

WELCOME TO DODGEVILLE

SO WE FLEW to Wisconsin for a look-see, goose-down parkas zipped to our chins. Without much fuss, I took the job. Upshifting furiously, we said goodbye to family and friends, collected our dental records, and found a house on the edge of Madison, a breezy commute across the tundra to Dodgeville (pop. 3,042, not counting cows). Aging parents? We did what we could, eventually relocating my wife's mother to Wisconsin. Friends? We got back to New York now and then. The kids? They met a few Vikings their own size, and all was fine.

And the job? Rewarding in every sense. It was a revelation, an inspiration, to work side by side with hundreds of people, from farmwives in the call center to copywriters late of the big city, who were all tethered to a single value: take care of the customer, and everything else (revenues, profits, job satisfaction) would take care of itself. Everything clicked. The company enjoyed a couple of record-breaking years. Then Lands' End was bought by Sears.

Financially, if not culturally, it was a great deal. But things were no longer the same—endless meetings, paralysis by analysis. Five years into the adventure we decided it was time to move on. We'd keep the kids in school, stay in the Midwest, but open a new chapter.

What about those pangs? Would they re-

LEE EISENBERG

IS THE FORMER EDITOR-IN-CHIEF of *Esquire* magazine, where he served for nearly 20 years. This piece is adapted from his new book, *The Number: A Completely Different Way to Think About the Rest of Your Life*, published this month by Free Press. Additional material may be found at TheNumberBook.com.

turn? In search of a clue, my wife and I sat down with a financial adviser, who later brought back pie charts and gave us a qualified thumbs-up. There'd be no fractional jets or houses for every season. But he showed how we could live in relative security: health-care and tuition costs covered, a sufficient standard of travel and leisure for the decades ahead.

WHAT'S YOUR NUMBER?

FOR A MONTH OR TWO I took it easy. Then the pangs returned, milder than before, but definitely back. Why? I decided to write a book about why. For a couple of years I toured the country, asking men and women in their 40s and 50s, Little

Red Hens and procrastinators alike, about their own pangs. I asked if they knew what their Numbers were—how much would it take for them to feel confident. I asked what compromises or sacrifices they were prepared to make if those Numbers fell short. I asked if they had pie charts, or did they simply navigate by the moon and stars, hoping for the best, as I'd done all those years.

Most people had trouble talking about these things. It was complicated, we agreed. Eventually I came to realize—duh—that money, while central to the pangs we talked about, wasn't the whole story. We aren't just fretting over how much, we're likewise groping at what for.

We all wanted more time, more money, but for what? Spreading mulch? Endless rounds of hooks and shanks?

By the time the book was finished I had learned something that I should have known seven years ago: that I was kidding myself back in that New York suburb. While "downshifting" was a nice way to put it, I was really just coasting, committed neither to work nor to so personal a passion. Those pangs? They were about money, yes, but they were also early warning signs of advancing uselessness. The move to Wisconsin was much an engagement play as a financial one. Whenever I get busy, it turns out those pangs are gone. ■

Retirement

Blaze Your Own IRA Trail

With a "self-directed" account, your funds can seek out unconventional investments. **BY TODDI GUTNER**

UNTIL NINE MONTHS ago, Hal Fong had a fairly typical individual retirement account (IRA) with all the usual vehicles: mutual funds, stocks, and bonds. Then he finally got tired of the so-so returns. So using a "self-directed IRA," he directed 20%, about \$125,000, into a private-equity deal, Pan Pacific Bank, a Fremont (Calif.) startup. Fong, a 51-year-old logistics manager at Home Depot in Northern California, expects the bank to be bought, merged, or taken public within three years, earning a 30% average annual return for his IRA.

More and more people are putting retirement dollars into everything from startups and real estate to race horses. (Life insurance and collectibles are the only investments prohibited in an IRA.) "For some investors, stocks and bonds don't make sense, and they're just more comfortable in other assets," says Paul Maxwell, chief operations officer of Trust

Administration Services, one of the custodial firms that handles the paperwork for such accounts.

Not everyone thinks it's a good idea. Such strategies can backfire for reasons unrelated to investing, says Ed Slott, an IRA consultant in Rockville Centre, N.Y. "There are a whole set of rules for self-directed IRAs, which require investors to be extremely careful," he says.

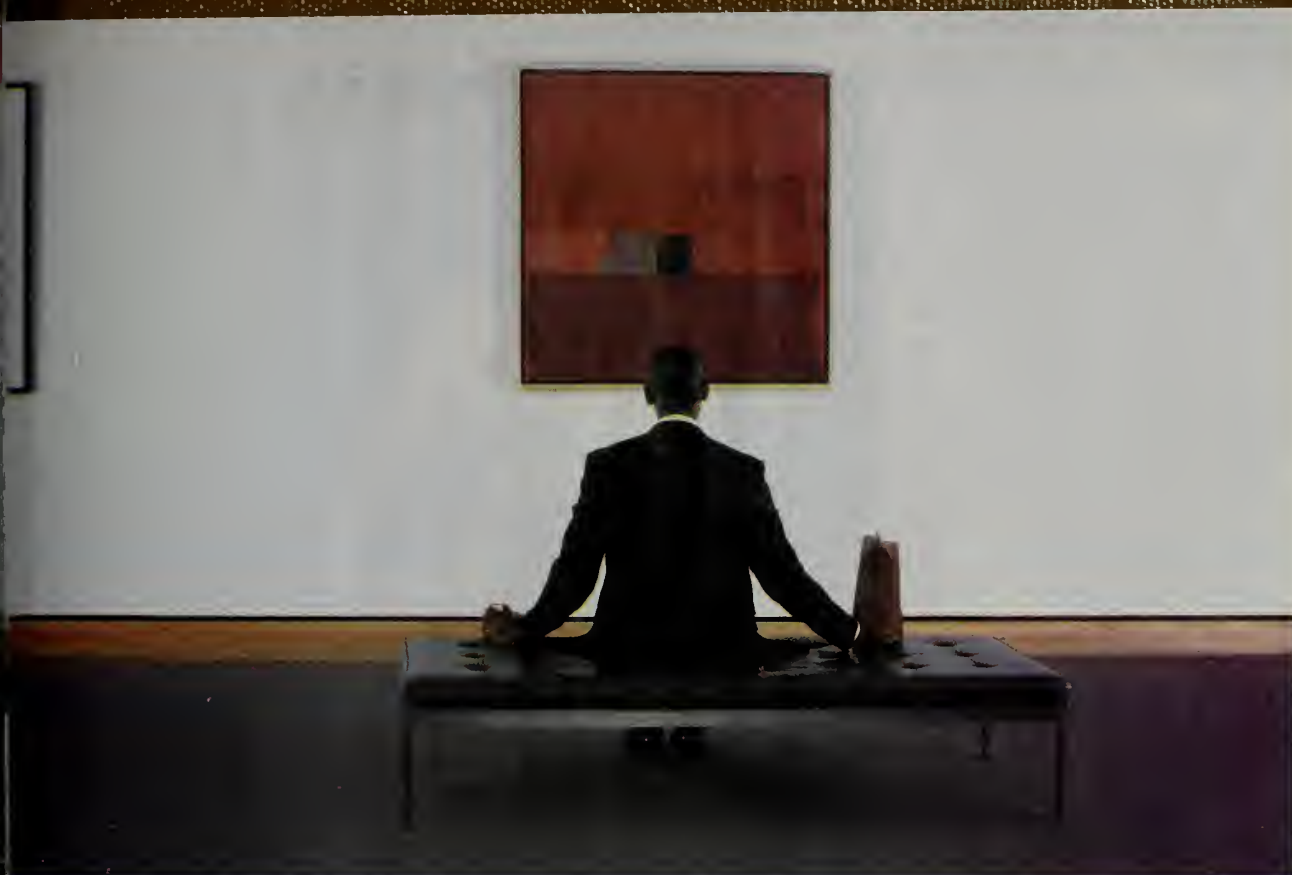
LOOKS FISHY

THE BIGGEST RISK is "self-dealing," meaning that you've effectively used these tax-deferred funds for current

Say you take \$100,000 from your \$1 million IRA to buy property on which you hunt and fish. If the Internal Revenue Service finds out about your personal use of the land, the entire \$1 million could be considered distributed, and all the money subject to income tax and withdrawal penalties for account owners younger than 59½. Slott says you shouldn't even let family members use the property, or any other asset in a self-directed IRA. The IRS may decide that this is a benefit to you.

Creating a self-directed IRA is easy. You can set up a bank's trust department or sign up with a custodial firm (table). They keep the books, disburse money, and collect profits for the investor, but they may not give





INVESTMENT ADVICE

and its effect on quality of life



Time, like all valuable resources, is finite. And it's our job to help you make the most of it. By providing financial solutions that are based on what you need, instead of what we have to sell. Adjusting those solutions over time, as your needs change. Using our resources to anticipate the opportunities, and minimize the risks. And organizing financial information in a way that's convenient for you. So you can get the most out of all your assets. Including your time. If you'd like to know more about how we can help, call William Morrison at 1-800-468-2352 or visit northerntrust.com.



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If you're opting for a self-directed plan, be prepared to do a lot of homework—or pay someone you trust to do it for you. Dennis Geraghty, a 59-year-old brand consultant in Monroe Township, N.J., spent six months doing research and ultimately invested \$250,000—half of his IRA—with a real estate developer who is building a 14-unit luxury condominium in Brooklyn, N.Y.

Geraghty also took some smart measures to make sure the

investment worked well. First, he split off money from his existing IRA and transferred that part into his new self-directed account. "This way, if there are any problems, all the retirement money isn't at risk," says Slott. Geraghty also invested alongside outside partners who would have a substantial ownership piece. This is especially important if you're using a self-directed IRA to start and operate a small business. Geraghty expects his investment will pay off in two years,

which is well before he will need the money at age 70½, when IRA owners must start taking distributions. (Some investors use rental income from IRA properties for their distributions.)

By committing half of his IRA, Geraghty is making a big bet. Most advisers would counsel IRA owners to keep such investments to the 10%-to-20% range, as did Hal Fong. After all, you want to make sure your retirement money is there when you need it. ■

BusinessWeek **weekend** For more on self-directed IRAs, watch our television show, *BusinessWeek Weekend* (check your local program listings for the time), or go to businessweekweekend.com



Don't Like Your 401(k)? Speak Up

Do your homework and you just might persuade plan execs to shake up the mix. **BY ANNE TERGES**

MOST ACCEPT AN employer's 401(k) plan as a fait accompli. Not Harry Kathirvel. The engineer, 30, frequently speaks up about the 401(k) plan at his company, Voith Siemens Hydro, a manufacturer of electric power equipment with North American headquarters in York, Pa. And those who oversee the plan often take note. Just over a year ago, at the suggestion of an employee committee that advises it on its 401(k), Voith added a large-cap fund after Kathirvel and others had criticized the performance of the one already in the plan. More recently, it has placed a second fund on "watch" for

possible termination. "Investing is one of the topics of our coffee chats" Kathirvel says of colleagues.

While no one wants to raise the ire of the people who sign their paychecks, Kathirvel can't afford to remain silent if your employer-sponsored 401(k) has high fees or investments that lag. Even a percentage point or two difference in returns over time can add up to thousands of dollars in lost retirement savings, especially for younger workers such as Kathirvel.

If you're dissatisfied with any of your 401(k) options, now is a good time to press for change. Thanks to recent suits over employee losses in 401(k) plans at WorldCom and Enron, among others, "the environment is right for employees to at least get a hearing,"

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Paul Bracaglia, a partner at PricewaterhouseCoopers in Philadelphia.

But don't think you can simply dash off an e-mail to your benefits department and get satisfaction overnight. Unless you're in a collective bargaining unit, you have little power, other than the power of persuasion, to change your plan, says Chris Bowman, a vice-president at Principal Financial Group, which provides 401(k) plans to businesses and individuals. To maximize your odds of success without ruffling feathers on executive row, you have to be diplomatic, persistent, and persuasive. "If your request has been well-researched, it's more likely the plan sponsor will consider it and get back to you," says Joseph Valletta, a partner at HR Investment Consultants.

Before starting a campaign, ask yourself if the change you're requesting will suit the needs of more than just a few people. Sure, you may want a hot sector fund, such as energy or gold. But your employer is unlikely to add a new option unless it covers a broad asset class that the plan currently overlooks, such as non-U.S. stocks.

It's also a good idea to get up to speed on your plan. Fund names alone don't always explain how their managers invest. You may think your plan is lacking, say, a mid-cap stock portfolio when in fact one

KATHIRVEL He was invited to join an employee advisory committee for his plan

of its funds includes that sector. You may also want to ask the benefits department for a "summary plan description," which spells out the plan's key operating rules. If your 401(k) uses regular mutual funds from, say, Fidelity Investments, T. Rowe Price, or Vanguard, you can get the expenses from the prospectus or the firms' Web sites. But if it invests in customized, commingled funds, your employer has to tell you what they cost. In any event, ask your employer if you're bearing any additional administrative expenses.

Then look at how your 401(k) plan compares with those offered by the average company (table)—or better still, a competitor. You'll have more leverage if you can show that what you want is widely available elsewhere. Likewise, back up your arguments. Document

poor performance with data or support a request for new fund options with research. "I armed myself with academic studies showing the diversification benefits of adding small-cap, value, and international exposure," says M. Shawn Bjerke, a biology instructor at Minnesota State Community & Technical College in Moorhead, Minn., who expects his plan's trustees to approve up to a dozen new funds soon.

Be patient, since most 401(k)s have bylaws that prevent decision makers from making snap changes. The "investment policy statement," available at your employer's discretion, lists the criteria the plan uses to select, monitor, and delete funds. For example, it

should say how much time has to elapse before the plan can remove an underperformer.

PAPER TRAIL

TAKE ADVANTAGE. Surveys and other tools that provide feedback on your 401(k). If you find your request isn't being taken seriously, contact someone with responsibility for the plan. At a small company, that may mean collaring executives named on the "summary plan description" in the hall. Otherwise, ask your benefits department for a name.

"Someone I found in an employee directory forwarded my e-mail to the right guy," says Andy Ciavarella, 43, a Wantagh (N.Y.) cable splicer at Verizon Communications. His gripe? Verizon's 401(k) won't let him sell the Verizon stock he gets as a company match until age 55. "It makes me nervous to have so much money in one stock," he says. Because the match was negotiated in his union contract, Ciavarella has taken the matter up with the union.

Your employer may find it hard to ignore your suggestion if colleagues back you. So speak to the investing enthusiasts down the hall. If your company has a 401(k) advisory committee similar to Voith's, reach out to members. When Kathirvel approached his, they invited him to join. "Create a critical mass," Bowman, who recommends communicating in writing since "this creates a paper trail the employer can use to track interest." Since companies often review their plans every three months, ask for a response within that period.

In your pitch, emphasize what everyone has to gain. Mike Ostrander, controller at Springfield (Ill.) law firm Kalki & Associates, recently sold a 401(k) lineup to his boss in part by pointing out that the law usually lets top executives save the maximum allowed—\$15,000 tax-free—only when employee participation reaches certain levels. What's the best way to press your case than by appealing to your employer's self-interest?

BusinessWeek weekend

For more on how to lobby for change in your 401(k) plan, watch our weekly TV show, *BusinessWeek Weekend* (check your local listings) or view this and other stories on your PC at businessweekweekend.com

How Does Your Plan Compare?

Before suggesting your 401(k) proposal to your employer, make sure you know how your plan stacks up. After all, you'll have more leverage if you can show that what you want is widely available elsewhere. And you have a better case to ask for more funds or lower fees if you know what plans of similar size offer.

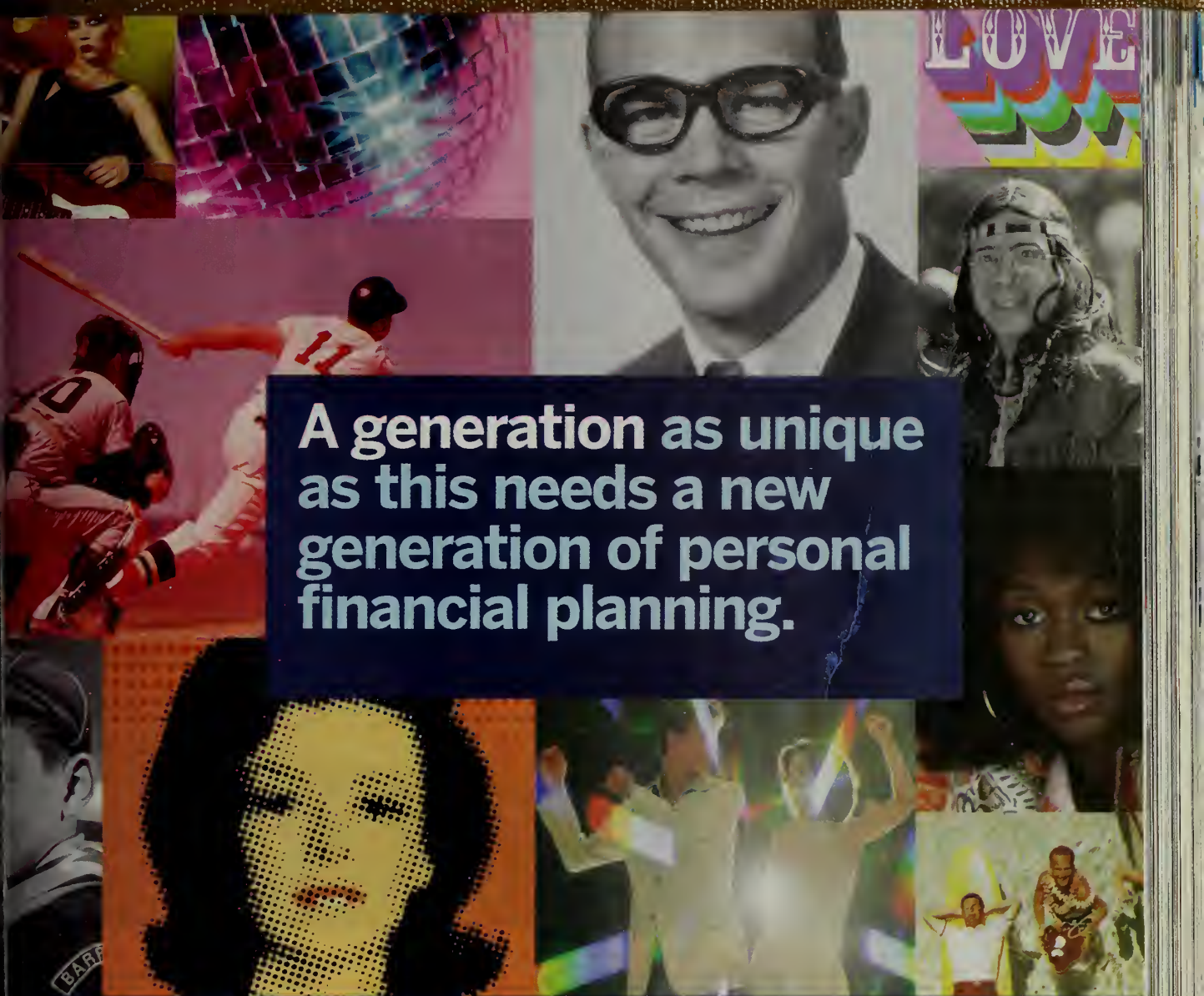
FEATURE	NUMBER OF EMPLOYEES				
	1-49	50-199	200-999	1,000-4,999	5,000+
Fees*	1.57%	1.36%	1.27%	1.19%	1.09%
Funds	23	16	16	16	20
Loans	81%	79%	88%	95%	90%
Internet transactions	87	91	93	99	96
Immediate vesting	34	20	24	31	45
Quarterly statements**	87	92	95	94	81
Employer match***	50 cents per \$1 invested, up to 6% of pay				

*HR Investment Consultants

**Profit Sharing/401(k) Council of America's Defined Contribution Plan Participant Statement Survey, 2005

***Most common arrangement, reported by 29.6% of 1052 plans

Data: Profit Sharing/401(k) Council of America, 48th Annual Survey of Profit Sharing and 401(k) Plans



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FINAL POLISH
This 1969
Chevrolet
Camaro SS
Coupe sold for
\$486,000

Muscle Cars Roar Onto the Block

Motorheads are making vintage gas guzzlers the new stars of the auction scene. **BY CHESTER DAWSON**

EVERY YEAR, THOUSANDS of motorheads from around the world flock to Scottsdale, Ariz., in late January for a series of classic car auctions. Pre-war American favorites such as Duesenbergs or Packards and rarified European sports cars from the likes of Aston Martin and Jaguar used to be the main attractions, as they are at the Monterey (Calif.) classic car show and

auctions held every August. But the biggest draw these days are more recent vintages: Chevy Chevelle Super Sports, Dodge Super Bees, and Plymouth Road Runners.

Gas-guzzling muscle cars died out with the onset of the oil shocks of the 1970s. So why are they making a comeback now, in the age of the hybrid? What's happening is a generational shift as baby boomers enter their peak earning years. For many drivers who came of age

when high-performance hemi engines ruled the road, potent powertrains trump the pedigree of traditional collector cars. A growing number of these buyers are paying top dollar for restorations of the coolest cars from their youth. "These are the cars of their dreams; they are putting a lot of money into restoring them," says Thomas duPont, publisher of *The duPont Registry* and *Classic Car* magazines.

Barrett-Jackson Auction, the most collectible car auction houses in the world by sheer volume, has also been the most active in courting this rapidly expanding base of newer collectors. In January, the auction house handled 1,084 vehicles (out of several thousand applications with bids adding up to a grand total of \$100 million, up from \$62 million in 2003 and \$39 million in 2004). CEC Jackson, 46, is something of a visionary for being among the first to recognize and capitalize on—the popular fervor for muscle cars. "Our success has been in companies sitting up and paying attention," says Jackson. Indeed, last year muscle car nameplates, the

Charger and the Pontiac GTO, reappeared, and Detroit is considering new versions of the Chevrolet Camaro and the Dodge Challenger.

Jackson's father, Russ, started the auction 35 years ago with a local partner, but the younger Jackson has transformed the annual event into a weeklong muscle car mecca. This year it attracted more than 225,000 visitors to a sprawling tent city with vendors selling everything from mink bikinis to furniture made out of car parts. For those who were unable to make the trek in person, Fox Cable Network's SPEED Channel carried live gavel-to-gavel coverage. "It has become a lifestyle event that dwarfs all other auto auctions," says Keith Martin, editor and publisher of *Sports Car Market* magazine.

Some serious collectors eschew the spectacle and showmanship altogether in favor of private transactions. "The good stuff goes before it ever gets to the auctions," says late night talk show host Jay Leno, an avid car collector. "Somebody dies, [and] you wait a respectable amount of time, and [then] you the widow and say: 'Would you like to Jimmy's Duesenberg?'"

he raucous bidding at Barrett-Jackson has more in common with pork-bellading on the Chicago Mercantile Exchange than the genteel proceedings of a Christie's International auction. Quick-ed auctioneers goad bidders in the ball-field-size main tent—the largest North America—with cries such as "You're Out!" and "Is that all you've got?" Celebrities often share center stage—rocker Sammy Hagar pumped crowd by offering to throw in free concert tickets and a

of tequila to winning bidder his 1967 Ford Mustang Shelby 350, which sold for \$250,000. "This is a motorhead's dream," said Hagar. "It's awesome."

Not all of the Arizona auctions are as circus-like as that, but Hagar has helped push



SHOWTIME
Stoking the crowd
at this year's
Barrett-Jackson
auction

muscle car prices into uncharted territory. While production volumes for these pony cars were generally larger than for prewar vehicles, the rarest models—such as a 1970 Plymouth Hemi 'Cuda convertible that Barrett-Jackson sold for \$2.16 million—often number in the low hundreds or dozens. The most highly sought-after muscle cars are those that have been restored to their original glory, usually with documented parts dating from the same production lot and a new paint job. On some of them you can pop the hood and see your reflection on the highly polished engine block.

PASSIONATE PLAYERS

NO ONE WILL EVER confuse the pedestrian sheet metal and vinyl interior of a muscle car with the handcrafted carriage and buttery leather cockpit of a multimillion-dollar Bugatti. But 10 years ago, a 1970s Ford Mustang Boss with a decent-size 302 engine might have garnered \$20,000. Today that car sells for around \$75,000. That's prompting more original owners to cash out. "I want to pay off the mortgage,"

says Hank LaPointe, 64, of Las Cruces, N.M., who sold his 1965 Ford Mustang Shelby GT350, painted Wimbledon white with a Guardsman blue stripe down the hood, for \$186,000. "I had it in storage for 10 years and had no idea it'd be worth as much as it is."

Collectible cars have had their ups and downs. A speculative spike in prices for European sports car such as rare Ferrari models led to a crash in prices in 1991. But as long as boomers continue to flood the market, muscle car prices will continue to climb. Still, "all of the muscle cars will hit a saturation point," says Drew Alcazar, president of Russo & Steele, a classic car auction house in Phoenix.

Keep in mind that most collectors consider their cars more of a hobby than an investment. Even those who plan to flip their cars back onto the market—after driving them around the block a few times, of course—recognize the risk and limit their exposure accordingly. But for some grease monkeys, investing in collectible cars they know and love beats trying to play the stock market. "This is my pension plan," says Bob Anderson, 61, of Phoenix, who bought a tuxedo black 1966 Chevelle SS for \$54,000 at the auction, adding to his six-car collection. "And this is my addiction." ■

—With Chris Palmeri in Los Angeles



BusinessWeek weekend To see the bidding frenzy for the cars featured here, watch our weekly TV show, *BusinessWeek Weekend* (check your local listings), or view it on your PC at businessweekweekend.com



EDITED BY TODDI GUTNER

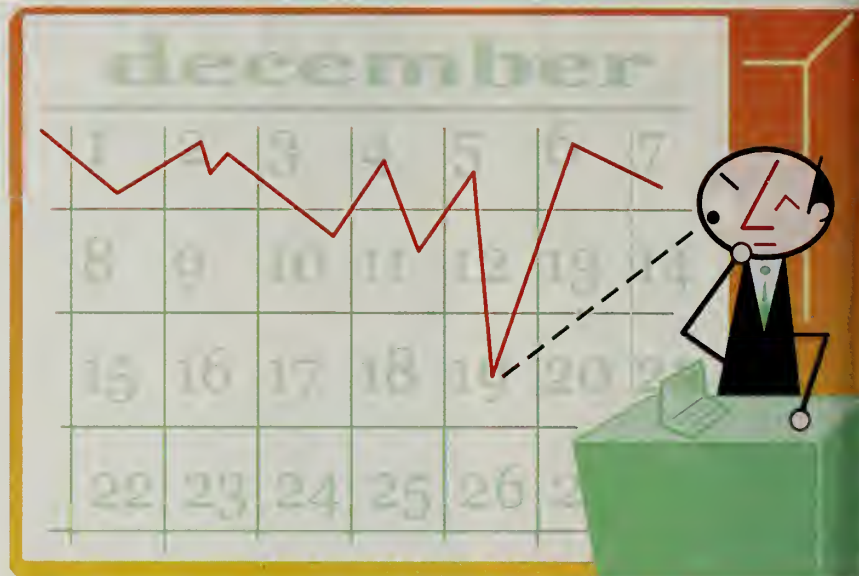
TIME OFF

BOSTON POP: AN ALL-HOCKNEY EXHIBIT

THE FIRST-EVER exhibition devoted solely to British Pop artist David Hockney's often playful, always intimate portraits will be on view from Feb. 26 to May 14 at Boston's Museum of Fine Arts. Spanning the past 50 years of Hockney's career, the show features more than 100 images of his family, friends, and fellow artists. The works include a half-finished color-pencil sketch of Andy Warhol, a 1977 painting of Hockney's parents sitting on wooden folding chairs, and several self-portraits. Tickets, \$22, go on sale Feb. 1 (mfa.org). —Reena Jana



INTIMATE
Hockney's
My Parents



STOCKS

The Winter's Tale

WALL STREET LORE holds that the stock market's performance in January, even in just the first five trading days of the month, is a reliable indicator of the full year's direction. The Standard & Poor's 500-stock index gained more than 3% in the first five days but has since sold off, with just a 1.5% gain through Jan. 24. If the S&P is in positive territory on Jan. 31, the so-called January barometer—which is 90% accurate—predicts a positive year for stocks.

When does it miss? In midterm election years like this one, its accuracy is just 64%, according to the *Stock Trader's Almanac*. That's why strategist Jeffrey Saut of Raymond James & Associates looks to confirm the barometer's call with an indicator developed by Wall Street analyst Lucien Hooper in the 1970s. Hooper said if the Dow Jones industrials close below the previous December's lowest closing price in the first quarter—it happened on Jan. 20 when the Dow fell 213 points—stocks will be down for the year. Saut says if both warnings are triggered, a down year is a sure bet. The bulls had better hope the S&P finishes January in the black. —Aaron Press

DEBT

DO THEY MEAN IT THIS TIME? Nearly two-thirds of the consumers polled for the *Experian-Gallup Personal Credit Index* survey say they are "very likely" to reduce their credit-card debt in 2006, and an additional 19% say they are "somewhat likely" to do so. Among other findings:

48%

SAID THEY ARE
"very" or "somewhat
likely" to check their
credit score at a
major credit agency

34%

SAID THEY PLAN
to take steps to
improve their
credit

35%

OF THOSE
with credit cards
said they will cut
the number of
cards they have

Data: PersonalCreditIndex.com

STAMPS

MONKEYING WITH THE MAIL

THE CONTENTS OF YOUR MAILBOX are about to get a lot cuter. With the new 39¢ rates, the U.S. Postal Service has issued its first class stamps featuring Curious George, Maisy the mouse, the Very Hungry Caterpillar, and other favorite children's book animals. Anticipating an enthusiastic response, the postal service (usps.com) printed 192 million sheets, double the amount for the typical commemorative stamp. Even so, "Get out and buy 'em fast," says David Failor, executive director of stamp services. They're expected to sell out quickly. —Lauren Young



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The Ericsson Racing Team is one of the seven teams to take on the great challenge of The Volvo Ocean Race, the incredibly tough round the world sailing event.

There are many skills needed to win the race, and one of these is the ability to adapt to ever changing conditions. Many IT and telecoms companies are equally finding that they need to be increasingly adaptable and flexible to meet their own needs and those of their customers. Ericsson, the global telecoms industry leader, is the perfect partner to meet this challenge.

There have been discussions for many years of convergence across the wireline, wireless, Internet and media worlds; the notion of providing services such as TV and video, high speed Internet, gaming, voice and data communications whenever and wherever the user demands it. The reality has been that each service has typically required its own network and management, and integrating these different networks and applications has proved highly problematic.

Enter the world of the Internet Protocol. Ericsson is the global leader in a new way of providing converged networks and services - the IP Multimedia Subsystem (IMS). Although this technology is very new, development and standardization work has been going on for many years and Ericsson is already undertaking commercial launches around the world.

So how does it work in practice? Innovative Australian service provider, Commander Communications, deployed IMS from Ericsson at the end of 2005. Commander will use the Ericsson technology to support all its wireline and Internet operations. Early applications will include IP PBX, replacing the office switchboard with a feature rich network based service, and voice over IP. In the future, Commander plans to offer such services as video telephony, presence management and instant messaging.

As well as the benefits for its customer base, the Ericsson IMS solution will offer a number of direct advantages for Commander itself. These include all the benefits of a single, converged network together

with quicker introduction of new services, greater reliability and lower costs. It is no wonder that telecom service providers around the world are looking at IMS as a basis for competitive advantage and a way of differentiating from rivals.

For users, IMS not only brings the promise of new and more advanced services, but the opportunity to have all their telecom services, whatever their underlying technology, provided in an integrated way. It gives users the option to get all their telecom services provided by one provider, with one bill. A particular beneficiary will be smaller businesses, who will be able to enjoy many of the sophisticated services previously only available to larger rivals.

An independent opinion comes from market analysts, the Yankee Group. They believe that, "the values and benefits of the IMS architecture are so significant that most wireline and wireless service providers will adopt this architecture."

As the boats leave Australasia for the next stage of the race, then the ability to adapt is separating the rival teams. Equally, telecom operators who are making the evolution to all-IP will be able to differentiate from competitors.

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WRITTEN BY
STEVE WALLAGE



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BY GENE G. MARCIAL

PROSPEROUS INDIAN CONSUMERS ARE BUOYING ICICI BANK.

IF DIAMOND SNACKS GET INTO WAL-MART, SALES MAY CRACKLE.

PROSTATE CANCER DRUGS FROM GTx ARE SHOWING PROMISE.

India's Go-Ahead ICICI

IT'S NO SECRET how fast India's economy is growing. For investors, the country "offers opportunities equal to those of China," says Steven Lord, editor of *Emerging Investments*, a newsletter that looks for attractive stocks overseas. As a former British colony, India has well-developed financial markets. The Bombay Stock Exchange, opened in 1886, is the oldest in Asia and boasts world-class technology, so capital flows are strong, says Lord. Among his top picks: ICICI Bank, India's No. 2, and fastest-growing, commercial bank. Its American depository receipts trade on the New York Stock Exchange with the symbol IBN. Consumer spending in India is surging, and ICICI's emphasis on retail banking, such as credit cards and mortgages, is driving its rapid earnings growth, he notes. He figures ICICI's stock, which jumped from 22 in late October to 31 on Jan. 25, could hit 50 in two years. He sees earnings of \$1.36 a share in the year ending Mar. 31, 2006, on revenues of \$2 billion, and \$1.60 in fiscal 2007, on \$2.6 billion, vs. 2005's \$1.21 on \$1.4 billion. Another ICICI bull: Rajeev Varma of Merrill Lynch in India, which has done banking for ICICI in the past year. He rates ICICI a buy, with a 12-month target of 38. Among big U.S. investors who have large positions in ICICI are Gilder Gagnon Howe Capital Management, with a 2% stake; Oppenheimer Funds, 1.7%; and JPMorgan Chase, 1.1%.



Diamond Foods: It Ain't Just Peanuts

AS ONE OF THE FEW NONTECH companies to go public last year, Diamond Foods—a distant No. 2 in snack nuts to Kraft Foods' Planter's line—is off to a strong start, rising from 15 in November to 20 by Jan. 25. "Diamond's Emerald nuts, sold mainly in California, are well on their way to becoming a national brand," says Stephen Cootey of Prides Capital, the largest investor in Diamond, with 5.5%. Cootey says Diamond's potential is enormous. Because it's tiny, with only 5% of the \$2.6 billion snack-nut market vs. Planter's 50%, Diamond's products are sold only in supermarkets, rather than the big outlets. But that's changing: Emerald is being tested at 500 Wal-Mart Stores, and Cootey expects Diamond sales will

jump when big chains (like Sam's Club and Costco) start selling Emerald. That's the reason he isn't fazed by Diamond's high price-earnings ratio: 25 times the 2006 (ending June 30) forecast of 78¢ a share. Estimates for 2007 run from \$1.29 to \$1.38. Meanwhile, Diamond's CEO Michael Mendes expects this year's 30-second Super Bowl ad to jack up sales the way last year's spot did.

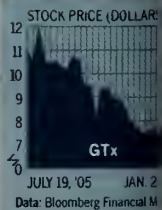
A POST-IPO RECOVERY



If Clinical Trials Pan Out, GTx Could Have a Winner

TINY BIOTECH GTx (GTXI) develops drugs mainly for prostate cancer. GTx' lead product, Acapodene, is in Phase 3 clinical trials for prevention of prostate cancer in men with precancerous lesions. Acapodene inhibits estrogen's harmful effects on patients treated for prostate problems—after their testosterone production is interrupted. "We expect the trials will be successful," says Mark Basham of Standard & Poor's. He rates the stock, now at 9, a four-star buy (five stars is tops), with a 12-month target of 18. It's a high-risk stock, he warns, since it depends on the trials' outcome. But if Acapodene succeeds, the market for it could be \$3 billion a year, Basham says. Acapodene's other use is to shrink tumors in men already suffering from prostate cancer. Another GTx drug, Andarine, counters weight loss in cancer patients. Its Phase 1 tests for safety are completed. Andarine is being developed together with Johnson & Johnson's Ortho Biotech unit. CEO Mitchell Steiner is seeking a partner for Acapodene. J&J, he says, is a possibility for Europe and Asia, but GTx is also in talks with others. (whose top officers control 60% of the stock, will handle the U.S. market. Steiner will seek approval for Acapodene in 2007 and possibly market it in 2008. ■

DOWN BUT MAYBE NOT OUT



BusinessWeek online Gene Marcial's Inside Wall Street is posted businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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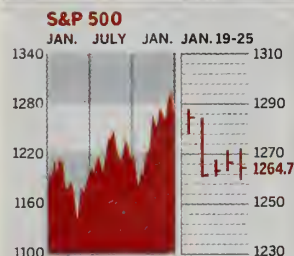
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STOCKS



COMMENTARY

It was a tough week for stocks, which fell sharply on Jan. 20 as concerns over Iran, rising oil prices, and poor earnings from GE and Citigroup sent investors scurrying. Rallies on Jan. 23-24 fizzled, despite good earnings from such blue chips as United Technologies and McDonald's. After jumping in the first 10 days of '06, the major indexes are about where they finished in '05.

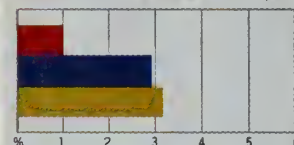
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED JAN. 24

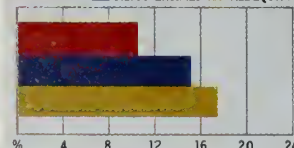
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED JAN. 24

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	JAN. 25	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1264.7	-1.0	1.3	8.2
Dow Jones Industrials	10,709.7	-1.3	-0.1	2.4
NASDAQ Composite	2260.7	-0.8	2.5	11.9
S&P MidCap 400	763.0	0.2	3.4	20.9
S&P SmallCap 600	369.9	1.4	5.5	19.1
DJ Wilshire 5000	12,749.1	-0.7	2.0	11.1

SECTORS

	JAN. 25	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	758.1	-1.7	2.2	10.7
BW Info Tech 100**	385.5	-0.9	1.3	10.4
S&P/BARRA Growth	603.0	-1.4	1.1	7.1
S&P/BARRA Value	657.5	-0.7	1.5	9.4
S&P Energy	409.8	0.9	10.0	40.5
S&P Financials	424.7	-1.6	-0.4	6.7
S&P REIT	161.8	1.5	5.7	21.8
S&P Transportation	256.8	3.7	2.8	16.2
S&P Utilities	164.8	-0.4	3.2	18.0
GSTI Internet	207.2	0.6	1.0	30.0
PSE Technology	860.3	-1.4	2.9	19.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	JAN. 25	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1578.1	1.7	4.4	18.1
London (FT-SE 100)	5704.4	0.7	1.5	1.1
Paris (CAC 40)	4791.0	0.4	1.6	2.3
Frankfurt (DAX)	5427.1	0.6	0.3	2.8
Tokyo (NIKKEI 225)	15,651.0	2.0	-2.9	3.8
Hong Kong (Hang Seng)	15,520.4	0.3	4.3	14.1
Toronto (S&P/TSX Composite)	11,675.2	1.0	3.6	2.2
Mexico City (IPC)	18,866.4	3.3	6.0	40.1

FUNDAMENTALS

	JAN. 24	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.79%	1.76%	1.91%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.2	18.7	19.1
S&P 500 P/E Ratio (Next 12 mos.)*	14.8	14.9	15.1
First Call Earnings Surprise*	3.81%	3.88%	2.6%

*First Call Call

TECHNICAL INDICATORS

	JAN. 24	WEEK AGO	YEAR AGO
S&P 500 200-day average	1218.1	1215.9	Posit
Stocks above 200-day average	67.0%	66.0%	Neu
Options: Put/call ratio	0.75	0.61	Posit
Insiders: Vickers NYSE Sell/buy ratio	3.88	3.96	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Steel	17.2	Oil & Gas Refining 96.2
Oil & Gas Equipment	17.0	Oil & Gas Equipment 74.1
Automobiles	16.5	Oil & Gas Exploration 72.9
IT Consulting	12.6	Constr. & Engineering 70.2
Gold Mining	11.9	Oil & Gas Drilling 65.5

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Internet Software	-15.1	Automobiles -
Educational Services	-12.2	Photographic Products -
Commercial Printing	-7.9	Auto Parts & Equipment -
Conglomerates	-7.7	Brewers -
Semiconductors	-7.0	Food Wholesalers -

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	13.9	Latin America	81.4
Precious Metals	13.2	Natural Resources	58.2
Natural Resources	12.6	Precious Metals	54.3
Diversified Emerg. Mkts.	9.2	Diversified Emerg. Mkts.	48.4
LAGGARDS		LAGGARDS	
Financial	0.2	Domestic Hybrid	8.8
Health	0.9	Miscellaneous	10.7
Japan	1.1	Large-cap Blend	11.0
Domestic Hybrid	1.4	Financial	11.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Oil & Gas Inv.	20.0	ING Russia A	97.9
ProFunds Precs. Mtls. Inv.	19.8	IShares MSCI Brazil Idx.	91.2
IShares MSCI Brazil Idx.	19.6	T. Rowe Price Latin Am.	90.0
U.S. Gl. Invs. Prec. Mnl.	19.6	ProFunds Ultra Japan Inv.	88.2
LAGGARDS		LAGGARDS	
ProFds. Sh. Oil & Gas Inv.	-11.7	Ameritor Investment	-63.2
ProFds. Ush. Sm. Cap Inv.	-11.1	American Heritage Grth.	-42.9
Potomac Sm. Cap/Sh. Inv.	-11.0	ProFds. Ush. Mid Cap Inv.	-32.4
Guardian UBS Sm. Cap Val. A	-9.1	ProFds. Ush. Sm. Cap Inv.	-30.6

INTEREST RATES

KEY RATES

	JAN. 25	WEEK AGO	YEAR AGO
Money Market Funds	3.88%	3.85%	1.1%
90-Day Treasury Bills	4.42	4.35	2.2
2-Year Treasury Notes	4.46	4.33	3.1
10-Year Treasury Notes	4.48	4.33	4.4
30-Year Treasury Bonds	4.66	4.51	4.4
30-Year Fixed Mortgage †	5.90	5.96	5.5

†BancQuote

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BONO	30-YR. B.
General Obligations	3.78%	4
Taxable Equivalent	5.40	6
Insured Revenue Bonds	3.84	4
Taxable Equivalent	5.49	6

THE WEEK AHEAD

PERSONAL INCOME Monday, Jan. 30, 8:30 a.m. EST » In December, income probably rose 0.4%, after November's 0.3% gain. That's the median forecast of economists polled by Action Economics. Consumer spending most likely grew 0.5%.

EMPLOYMENT COST INDEX Tuesday, Jan. 31, 8:30 a.m., EST » Compensation is forecast to have increased 0.9% in the final quarter of 2005.

FOMC MEETING Tuesday, Jan. 31, 9 a.m. EST » The Federal Reserve's Open Market Committee meets to set monetary policy. The unanimous expectation is that the central bank will raise the fed funds rate from 4.25% to 4.50%.
PURCHASING MANAGERS' INDEX Wednesday, Feb. 1, 10 a.m. EST » The Institute for Supply Management's January factory activity index most likely edged up to 55%, from 54.2% in December.

PRODUCTIVITY & COSTS Thursday, Feb. 2, 8:30 a.m. EST » Output per hour worked probably grew at a 2% annualized rate in the fourth quarter, after a 4.7% rise in the prior period. Unit labor costs very likely grew by 2.8%.
EMPLOYMENT Friday, Feb. 3, 8:30 a.m. EST » January nonfarm payrolls probably grew by 225,000 positions after a gain of 108,000 in December. The jobless rate most likely held at 4.9%.

The BusinessWeek production index rose to 271.7 for the week ended Jan. 14, and stood 12.9% above the year-ago level. Before calculation of a four-week moving average, the index rose to 269.4.

BusinessWeek on

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/e

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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IdeasBooks

Up Against It at 25

STRAPPED Why America's 20- and 30-Somethings Can't Get Ahead

By Tamara Draut; Doubleday; 277pp; \$22.95

GENERATION DEBT Why Now Is a Terrible Time to Be Young

By Anya Kamenetz; Riverhead; 265pp; \$23.95

Tamara Draut and Anya Kamenetz have a long list of grievances: Flawed government policies have forced many students to borrow huge sums for college. Once they enter an increasingly competitive workforce, these young people find that traditional benefits, such as

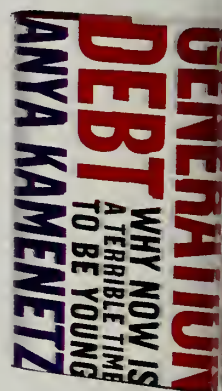
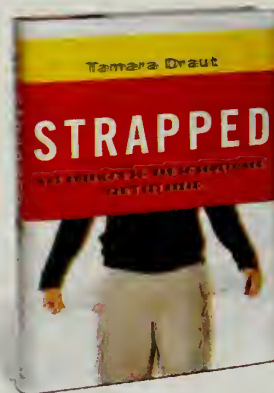
health care, have become scarce. A consumer culture nudges them toward credit-card dependency. Meanwhile, an older generation of self-satisfied baby boomers will soon begin retiring, sucking up government resources. The authors' complaints are aired in two new and often compelling books: Draut's *Strapped: Why America's 20- and 30-Somethings Can't Get Ahead* and Kamenetz' *Generation Debt: Why Now Is a Terrible Time to Be Young*. The volumes are similar economic jeremiads, although Kamenetz is the better writer and Draut the more knowing policy maven.

If you're thinking that you've heard enough already—what's with these kids?—then you should definitely read one of these books. The authors' insistence that they've struggled more than any previous generation may annoy you. The research and statistics they cite may seem skewed. I couldn't be a more understanding reader—my recent *BusinessWeek* story "Thirty and broke: The real price of a college education today" (Nov. 14, 2005) looked at how student-loan debt was constraining the lives of three graduates. Yet even I found the books somewhat irritating.

But to get over that, try looking at *Strapped* and *Generation Debt* as guides to what may be a foreign culture full of young people whose professional ambitions are often frustrated and whose expectations of material comfort may

never be met. You could come away thinking that they have a point. Or at least you might better understand your own children.

Draut and Kamenetz weave stories of their own lives in with those of others. These personal histories didn't convince me that their generation has it so bad. It's true that the 30-something Draut and her husband have an awful lot of student debt. But she's director of the economic opportunity program at



Demos, a think tank in New York, not an ill-paid temp. Kamenetz, meanwhile, graduated from Yale without any student-loan debt. She's a freelance writer who, at the age of 24, has published a book. It doesn't seem that she's having such a terrible time of it.

Many others they cite have it worse. One of Kamenetz' examples is 24-year-old Nita, who would have been the first in her family to earn a college diploma, but instead has twice dropped out because of the expense. Now, she's working for minimum wage at a dollar store. Us, at 28, has tired of his job as a compute

grammer. He'd like to get a job
ordinating aid to developing countries
is wary of the debt that getting a
requisite MBA would entail. Dylan, one
draut's subjects, had to declare
ruptcy only five years out
college. She had built up
\$10,000 in credit-card debt
while toiling at a low-wage
job in publishing.
Many of these people feel
they've gotten a bum deal.
They were raised to dream
and then told they would have
to make compromises for the
lack of money. They grew up
cheated by marketers, and
now they are vilified for being
too materialistic. They are dissatisfied
and angry at the older generation.
draut lays the blame on public policies
that "have failed to address changing
realities in the workplace, in the
economy, and in the home." Her
criticisms range from apprenticeship

Do young people really have such a bum deal?

programs for those in dead-end jobs to
more government grants for college
students. She would like to see the home-
mortgage deduction limited so that it's
not, in her terms, another tax boon for
the privileged. And she thinks
the credit-card industry needs
more regulation. Kamenetz
isn't specific about policy. But
like Draut, she urges youth to
get more involved in politics.
In the end, *Strapped* and
Generation Debt are coming-
of-age stories. They are full of
youthful outrage and
disappointment, marred by
too little perspective. How
you regard them may well
depend on your age. While younger
readers may see a real crisis, baby
boomers will probably view their
concerns as nothing more than a phase
they should outgrow. I think those
boomers would be wrong. ■

—By Susan Berfield

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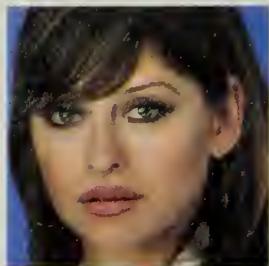
HARDCOVER BUSINESS BOOKS

- 1 **FREAKONOMICS** Steven D. Levitt, Stephen J. Dubner (Morrow • \$25.95) Crack gangs, the Ku Klux Klan, and more.
- 2 **THE WORLD IS FLAT** Thomas L. Friedman (Farrar, Straus & Giroux • \$27.50) Globalization is great—sort of.
- 3 **BLINK** Malcolm Gladwell (Little, Brown • \$25.95) Why snap judgments deserve careful consideration.
- 4 **JIM CRAMER'S REAL MONEY** James J. Cramer (Simon & Schuster • \$26) The CNBC commentator's trading tips.
- 5 **THE LITTLE BOOK THAT BEATS THE MARKET** Joel Greenblatt (Wiley • \$19.95) A hedge fund manager's "magic formula."
- 6 **COLLAPSE** Jared Diamond (Viking • \$29.95) Why civilizations fall apart.
- 7 **THE LITTLE RED BOOK OF SELLING** Jeffrey Gitomer (Bard Press • \$19.95) A syndicated columnist explains why people buy.
- 8 **THE MONEY BOOK FOR THE YOUNG, FAULOUS & BROKE** Suze Orman (Riverhead • \$24.95) Career plans, credit, etc.
- 9 **THE GOOGLE STORY** David A. Vise, Mark Malaseed (Delacorte • \$26) The search engine, from startup to Wall Street phenom.
- 10 **WINNING** Jack Welch with Suzy Welch (HarperBusiness • \$27.95) How to succeed within a company and against the competition.

PAPERBACK BUSINESS BOOKS

- 1 **GETTING THINGS DONE** David Allen (Penguin • \$15) Organizing your office and managing your time.
- 2 **J.K. LASSER'S YOUR INCOME TAX 2006** The J.K. Lasser Institute (Wiley • \$16.95) Happy New Year!
- 3 **WHAT COLOR IS YOUR PARACHUTE?** Richard Nelson Bolles (Ten Speed Press • \$17.95) The 2006 edition of the enduring job-search bible.
- 4 **GOOD TO GREAT AND THE SOCIAL SECTORS** Jim Collins (Collins • \$11.95) How noncorporate organizations can excel.
- 5 **THE 8TH HABIT** Stephen R. Covey (Free Press • \$15) In the new workplace, leaders must demonstrate trust, respect, and openness.
- 6 **THINK AND GROW RICH** Napoleon Hill (Ballantine • \$7.99) Willpower matters.
- 7 **GUNS, GERMS AND STEEL** Jared Diamond (Norton • \$16.95) Why the West triumphed.
- 8 **CRUCIAL CONVERSATIONS** Kerry Patterson, Joseph Grenny, Ron McMillan, Al Switzler (McGraw-Hill • \$16.95) Talk that counts.
- 9 **YOU CAN BE A STOCK MARKET GENIUS** Joel Greenblatt (Fireside • \$14) Mergers, restructurings, and more.
- 10 **THE MILLIONAIRE REAL ESTATE AGENT** Gary Keller with Dave Jenks and Jay Papasan (McGraw-Hill • \$19.95) Models that can make a real estate career soar.

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IdeasFaceTime

WITH MARIA BARTIROMO

What They Said at Davos

THIS YEAR'S World Economic Forum in Davos focused largely on the impact that the rising economies of China and India will have on the rest of the planet. But many world leaders and thinkers here on the Swiss Alps made only peripheral mention of the emerging behemoths when they were asked:

What is the most important issue for business in 2006?

TOM RUSSO *Vice-Chairman, Lehman Brothers:* We could easily see a scenario where the [Iran-Israel situation] develops into a major confrontation. Imbalances—the trade imbalance, to a lesser extent the deficit—can have a major impact on the dollar. Avian flu: High risk, low probability, but if it should happen, people won't come to work. We are trying to figure out how to run a firm from home. There are a lot of things with a low probability that can have a major impact. So this period of calm we are in is a bit deceptive. On the other hand, the U.S. economy is strong, unemployment is low, job creation high.

MARTIN SULLIVAN *CEO, AIG:* The threat of terrorism. That is the single biggest thing on a macro level, [especially] given the events in London, Jordan, and Madrid.

LARRY SUMMERS *President, Harvard:* Two issues: Will the co-dependency of U.S. borrowing and foreign lending...be disruptive? And what will the growth of skilled production in India and China mean for the structure of the global economy? That will be the story of the decade.

ZHANG XIN *Co-CEO, real estate developer SOHO China:* Coming from China, the single biggest challenge is income disparity. You see the high end growing faster...[while] the mass population is still trying to satisfy basic needs. Then you have the government saying we can't allow prices to grow too

much. That hurts our business and the group that is the engine of growth.

BRYAN MOSS *President, Gulfstream Aerospace:* The most important issue is the level of confidence in the economy. Key decision-makers have over a multiyear span. We can't talk ourselves into a downturn. Another near-term concern is the situation in the Middle East. To me, Iran could get out of control very quickly.



SNAPSHOT

THE INCONGRUITY OF THE SCENE at Davos goes well beyond men in suits and Timberland boots. In fact, odd couples were everywhere. **Michael Dell** was chatting up new German Chancellor **Angela Merkel** about her trip to the U.S. to meet President Bush. And at a party, Google Co-Founder **Sergey Brin** communed with Citigroup executives, telling them: "I don't see us as a threat to Microsoft, but I can see why they think of us as a threat." Earlier **Pervez Musharraf** huddled with several CEOs as he discussed investing in Pakistan. The president was a pitchman.

ANN WINBLAD *Partner, Hammer & Winblad Venture Partners:* The most important issue is to be an innovator. You can't participate in the global market unless you're looking ahead.

JOSEF ACKERMANN *Chairman, Deutsche Bank Management Board:* Biggest risk is a terrorist attack or a collapse in oil prices because real estate prices are so high.

VICTOR CHU *Chairman, First Eagle Investment Group:* Bird flu. It will impact everything, and you have to be prepared. If we don't have an epidemic by June, then we are O.K. For now, that is the most important issue. No. 2 is Iran.

THOMAS FRIEDMAN *Author of The World Is Flat and New York Times columnist:* One word: energy. The biggest risk for 2006 is that oil prices stay high.

CRAIG BARRETT *Former Chairman, Intel:* The continued movement of content into the digital sphere and the Internet. All the [action] you've seen in the last six months, including Disney-Pixar and getting Steve [Jobs] on their board [at age 62], will [speed up that process]. It's not just entertainment; it's news, too. All industries will get impacted by the dramatic shift in the delivery of content.

SERGEY BRIN *Co-Founder, Google:* The environment and global disasters. Global poverty. All businesses should be talking about these issues. ■

Maria Bartiromo is the host of CNBC's Closing Bell.

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A CONVERSATION WITH ANDREA JUNG

Avon, the Net, and Glass Ceiling

Avon Products Inc., the world's largest direct sales cosmetics company, is facing increasingly stiff competition from discounters and a slowdown at home and abroad. Late last year, Chief Executive Andrea Jung announced a restructuring plan to revive growth that will cost up to \$500 million. On Jan. 19, she spoke with Editor-in-Chief Stephen J. Adler as part of *BusinessWeek's* Captain of Industry series at New York's 92nd Street Y. Here are edited excerpts:

Is the direct sales model much more challenged in the U.S. than it is overseas?

We're not trying to go head-to-head with Wal-Mart. If we do our job right, I have a relationship with your wife—she is my friend, and she trusts me. It's the opposite of obsolete. As long as you believe that a person-to-person relationship counts, and it's not just a transaction, I think we have a continued opportunity—not just at Avon, but in the U.S. Direct selling has changed, too. It isn't “ding-dong,” knocking on doors. The Internet is an important tool for our representatives, and in over 80% of offices around America someone is an Avon representative.

Does the Internet ultimately help you or hurt you?

It's a huge enabler. Some 70% of Avon representatives do business online. The efficiencies are huge. It costs a dollar-something to process a paper order and about 11¢ online. And with the Internet you can combine high tech and high touch.

How do you deal with criticism?

I think you're never as good as they say and you're never as bad. The truth is somewhere in between. Certainly there has been criticism of the business in 2005. It was not the year that we had hoped for, but the business model is very sound. I'd rather be us any day than companies that just compete for the same shelf space day in, day out.

Managers joining Avon have to be sales reps for a while. I have a little trouble imagining you doing that.

It was a humbling experience. But it brought to light even faster some of the dramatic changes that needed to be made.

How do you set up a rapport with people who obviously aren't as stylish as you?

The whole business model is built around respect. These women, not just here in the U.S. but everywhere, come to the company wanting to be independent, have an earnings

opportunity, run their own businesses. I have seen extraordinary ways that they have changed their lives. We have this opportunity to teach younger women how to be entrepreneurs.

Does it offend you that you're always on the list of the top female CEOs?

I have mixed feelings. I hate that there is a differentiation. But the numbers still say that there is a glass ceiling. I'm actually optimistic. In the next five years, I think you're going to see dimensionally different opportunities for women.

“What's important is to have [men and women] thinking around the table”

Do you think women manage differently than men do?

There are some gender traits. I used to think it was a stereotype. But men can be more linear in decision-making, you know, A to B, and there are a lot of times that I find women try and go from A to C to D to circle all options. One is not better than another. What's important is to have both groups of thinking around the table. I would not advocate having all women around our table at all.

What does a CEO like you do all day at the office?

I actually haven't been in my office much since Jan. 2 because so much of our business is outside the U.S., so I have been traveling. We own and operate more than 50 businesses in 120 countries, and that is where the work happens.

Are your children aware of how special the role is that you play, and do they talk about it? Or are you just a mom?

I'm just Mom. I remember there was a list that came out of the most powerful women and as I was reading it, my son was saying, “You are not the boss of me.” Obviously, it's not easy to balance work and the children but no different than for other women and men, I would say.



BusinessWeek

13, 2006

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UNMASKING THE ECONOMY

Why it's so much stronger than you think

BY MICHAEL MANDEL (P.62)



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A photograph of a golf course on a misty day. A golf cart is visible in the middle ground, driving across a green fairway. The background is filled with trees and a soft, hazy atmosphere. A dark blue rectangular box is overlaid on the upper left portion of the image, containing white text.

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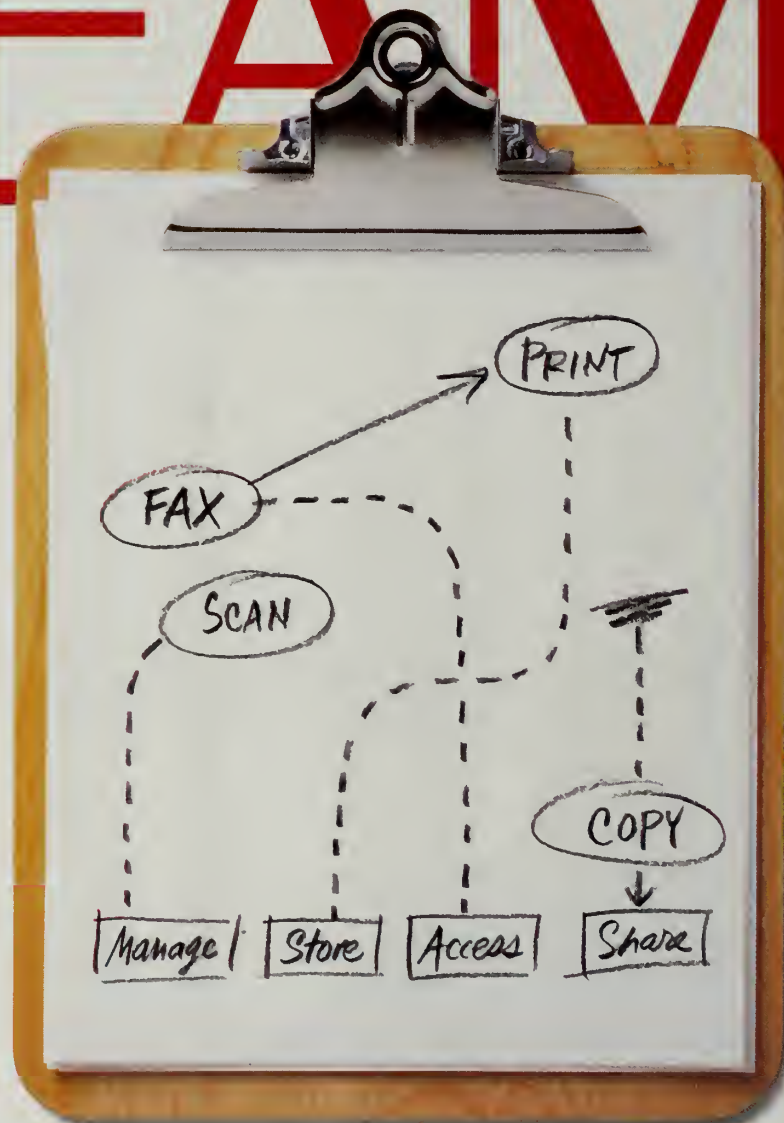
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JP Front

"We are not going to do anything stupid."

—Google CFO George Reyes, to AP, countering speculation that the company will change its philosophy after missing analysts' earnings estimates

EDITED BY DAN BEUCKE

PARMA FACTS PFIZER HAS CHANGE OF HEART

NEWS ON the cholesterol-ing front: In a little-expected statement in early January, **Pfizer** CEO Henry McKinnell held out the possibility that Pfizer would make a crucial product it is developing for making good cholesterol, LDL, available for use with other companies' heart drugs. It's a major change from the company's clearly articulated plan to develop the drug, torcetrapib, in a single pill adding its \$12 billion statin competitor, which is prescribed

separately to lower bad cholesterol. Critics slammed Pfizer, saying some patients who could benefit from the HDL drug don't need Lipitor.

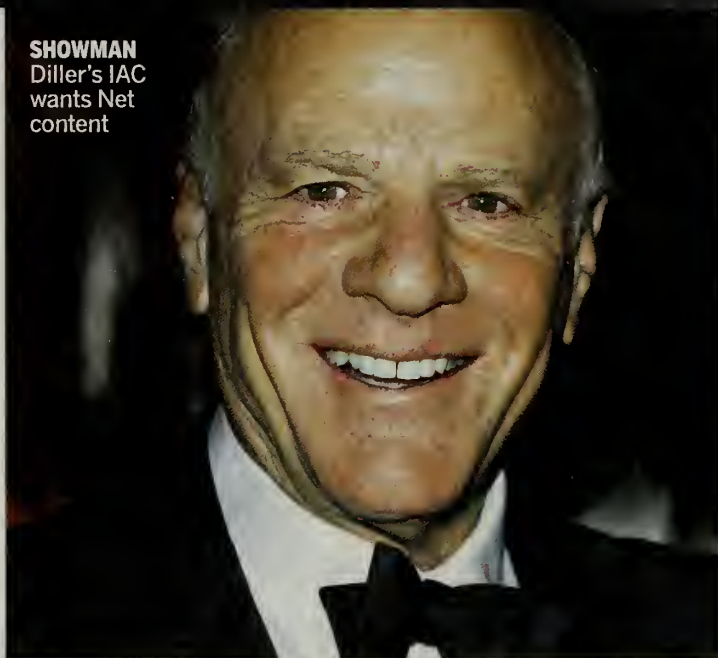
Now McKinnell is singing a different tune. At a **Morgan Stanley** conference he said Pfizer would consider making torcetrapib available with other statins. A spokesperson says Pfizer never ruled that out. But Jami Rubin, an

analyst at Morgan Stanley, says Pfizer's position has shifted and is likely "a reaction to political pressure from the [FDA] and the

medical community." Also a factor, perhaps: **Roche** is developing a stand-alone HDL-raising drug. If Roche succeeds and Pfizer doesn't adjust, it may be at a disadvantage. —Amy Barrett



SHOWMAN
Diller's IAC
wants Net
content



AMUSEMENTS

Barry's Back in The Spotlight

YOU CAN TAKE THE MOGUL out of show biz—but if you're Barry Diller, it's hard to stay away. With his hiring of British TV exec Michael Jackson on Jan. 29, the CEO of Internet retailing giant **IAC/InterActiveCorp** is trying to tap the small but fast-growing world of online entertainment. Jackson, who created shows like Trading Spaces, wants to create or buy programs with links to Diller's shopping assets, such as **Home Shopping Network**, **Ticketmaster**, and **Match.com**. (Imagine a music video that clicks over to ticket sales for the performer.) Within hours of his hiring, investment bankers were scrambling to pitch ideas. What's Jackson targeting? "We'd like to look for a site like **AtomFilms** or **IFilms**," which produce three-minute animated and live-action shorts. IFilms was recently bought by **Viacom**. AtomFilms CEO Mika Salmi says IAC hasn't rung—"but if they do, we'll add them to the others who have called."

Jackson says Diller's interest was piqued by a rush of online production, from **AOL's** airing of the Live Aid concert to **JibJab Media's** political shorts. "It's a real business with real revenue in subscriptions and advertising," says former **Nickelodeon** studio chief Albie Hecht, whose new **Biggies Broadband** creates online shorts. That's something Diller can relate to. —Ronald Grover

THE BIG PICTURE

GRADE DEFLATION Whether they're victims of global competition or just more tolerant of risk, fewer U.S. industrial corporations qualify for **Standard & Poor's** top credit rating (AAA). In the early '80s, there were 32. Today there are six:

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RETAIL DETAIL LABOR LOVES WAL-MART'S LOW PRICES

UNION LEADERS rail against **Wal-Mart Stores** (page 78), but new research suggests that workers' anger doesn't blind them to a bargain. Tom Hayes, a principal at **New England Consulting Group** (NECG), analyzed two market-research surveys that included 50,000 responses—and were not financed by the store. Hayes found that 60% of union members had visited a Wal-Mart in the past month, vs. 57% of all shoppers.

Hayes says Wal-Mart has

more unionized shoppers than any other retailer—more than double the number for **Sears** and 40% more than for **Target**. Says Hayes: "The savings are too much to resist."

The **AFL-CIO**, which has led efforts to unionize Wal-Mart's stores, contests the findings. Jason Judd, a spokesman, points to union-sponsored research that shows members shop at Wal-Mart much less frequently than other

stores. He also notes that NECG hosted a 2004

Webcast advising clients on how to do business with Wal-Mart, and recently hired Tom Muccio, **Procter & Gamble's** former liaison to Wal-Mart. Hayes says Muccio wasn't involved in the research and NECG doesn't work for the retailer.

—*Jessi Hempel*



BLOOD WILL TELL

HOW MUCH DO you really want to know about your health? If the answer is everything, and fast, consider a \$3,400 blood test. **Biophysic Corp.** in Austin, Tex., hopes its **Biophysical25** will undercut blue-chip executive physicals popularized by such institutions as the **Mayo Clinic**. A health-care worker comes to your home to draw about two tablespoons of blood. It is scoured for more than 250 protein biomarkers that signal the presence of disease or disease risk factors. Results come back in about two weeks. The test doesn't cover diseases for which there is no cure, such as Huntington's, multiple sclerosis, and Lou Gehrig's. For that depressing verdict, you'll have to ask your doctor.

—*Catherine Ar*

BLOGSPOTTING

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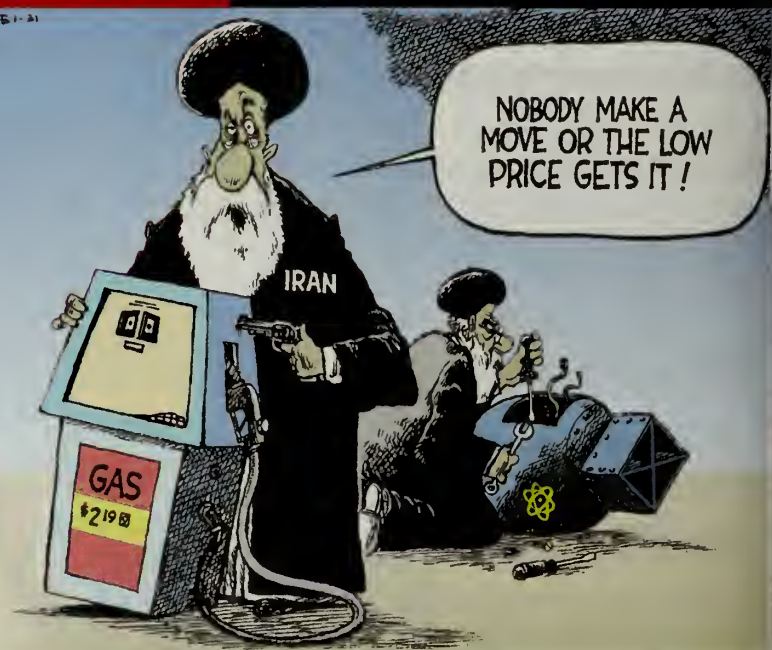
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HEALTH WATCH



HSAs: PROGNOSIS NEGATIVE

Health savings accounts (HSAs) are sold as a tonic for skyrocketing health insurance costs, forcing careful spending and getting doctors to compete on price. About 3 million people are covered by the high-deductible policies, three times as many as a year ago, says America's Health Insurance Plans, a trade group. And now President Bush wants to expand HSAs as part of a plan to lower health costs. But detractors fear that HSAs lure the young and healthy, leaving traditional insurers saddled with big payouts for the old and sick.

Now naysayers have some data to make their case. The General Accountability Office reports that a three-year-old U.S. Postal Service HSA plan is drawing younger and healthier workers. The average age of union members choosing the plan was 47, vs. 62 for those in a preferred provider plan. HSA users also were more likely to say they were in "excellent" or "very good" health. The GAO didn't have enough data, though, to say if they spent less on drugs and doctor visits.

—Lorraine Woellert

CLASS NOTES

HOW TO PLAY FOLLOW THE LEADER

ON FEB. 24, the Kravis Leadership Institute at Claremont McKenna College in Claremont, Calif., will open its 16th annual leadership conference. That's hardly newsworthy: There are hundreds of such confabs, and yes, Rudy Giuliani seems to give the keynote speech at every one.

But this one's a little, um, different. The theme this year: "followership." It's a discipline that emphasizes independent thinking among those not in leadership roles. This is a field that hasn't gotten its due—partly because of the term itself. "It has lots of negative connotations, like being sheep and being herded," says Barbara Kellerman, a research director at Harvard's Kennedy School of Government.



Kellerman, who last year launched what is probably the first university class devoted to the topic, is trying to change that. She's teaming up with others, including Ira Chaleff, an executive coach and one of the forum's organizers. Chaleff hopes the conference will help develop a community of scholars and perhaps produce a professional journal on followership. It's also a way to shift focus to the other half of the equation. "There's a dynamic that plays out between leaders and their followers," he says. "Instead of being a balancing force,

they [followers] often become a colluding [one]."

While there's truth in the idea, there's still plenty of work to do to make this a fledged crusade. For one, the concept of followership seems hard to define. "I would devote Ira on this," says Ronald Riggio, the institute's director. "That's a sand trap," says Chaleff when asked exactly what the term means, despite writing *The Courageous Follower: Standing Up to & for Our Leaders* (Berrett-Koehler, 2003). "I tend to steer around it." Clearly, this is a movement still in search of a leader. —Jena McGraw

TV GUIDANCE

KICK-START YOUR CAREER WITH MTV

IT'S GETTING EASIER for college kids to get career advice from reality TV. *The Opening* first appeared last fall on mtvU Über, an MTV Networks channel beamed to campuses. Each five-minute episode follows a day in the lives of recent grads at their first jobs. Now, thanks to a deal with MonsterTRAK, a student-recruitment unit of Monster.com,

viewers can go to mtvu.com and apply for jobs in featured industries. Clips from the show can be seen online, or via cell phone by subscribers of Verizon Wireless V Cast and Amp'd Mobile. "We really wanted mtvU to be the ultimate jobs hub," says Stephen Friedman, general manager of mtvU.

Many of the featured entry-level stars haven't been typical cubicle dwellers. They have included a consumer marketing assistant at EA

Games who tested video games with pro athletes and a medical technologist who examined a four-foot-long tapeworm at a lab.

—Helena Oh

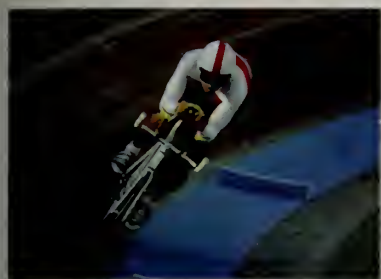


THE STAT

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The percentage of institutional investors that think corporate executives are overpaid. Almost as many of them (85%) say the executive compensation system hurts Corporate America's image.

Data: Watson Wyatt Worldwide survey of 55 institutions



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High school classes... must instill a greater fascination in math by showing the vast fields to which it can be applied."

—Kevin Graney
 Newtown, Pa.



WHAT MATH CAN AND CANNOT DO FOR BUSINESS

YOUR ARTICLE "Math will rock your world" (Cover Story, Jan. 23) made clear to me the many industries where math talent is needed. The latest hype is the outsourcing of American jobs, many in math-related fields, to Asia. If we want to put a stop to this trend, we must encourage a greater interest in math-related career paths at the high school level and below.

In my experience, math classes are taught in the most bland and uninteresting way, leading many students to despise the subject. Corny "word problems" are not enough to persuade students to pursue careers in math. High school classes need to move beyond just teaching math and must instill a greater fascination in math by showing the vast fields to which it can be applied.

—Kevin Graney
 Student
 Council Rock High School North
 Newtown, Pa.

I FOUND it unfortunate that you trotted out one of the usual solutions to the math problem, namely "engaging more girls and ethnic minorities." What this

usually ends up meaning is that the few resources available are diverted to programs focused solely on gender, race, or ethnicity, and not on the student's talent and interest level. But even worse is what I see at my son's elementary school, where it is clear that the emphasis, both in time and money, is on bringing the underachieving students up to a basic level. Few resources are spent on the students who are excelling already. The GATE (Gifted and Talented Education) program at our school receives only enough funds to pay for one day of specialized instruction.

To make matters worse, the schools generally will not group the high achievers together. Instead they are deliberately spread out, a few to each class, with the supposed belief that this benefits all students. The end result is that they lose interest in math because all they experience in school relative to math is boredom.

—Thomas Fuchs
 Bonita, Calif.

EVERY STUDENT in this country should read "Why math will rock your world" to understand why a strong math education is important and to answer the question,

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ReadersReport

"When are we ever going to use this?" It's up to all of us—teachers, parents, and business—to inspire our youth and help them excel. "We All Use Math Every Day," a program brought to life through the partnership of a leading technology company and the entertainment industry, and in association with the National Council of Teachers of Mathematics, is helping to do just that by providing teachers with real-life activities based on the math used in the CBS television show *Numb3rs* (cbs.com/numb3rs).

Each week, teachers and students can discuss the math behind the show's crime-solving. More than 20,000 have signed up for this math program, with thousands downloading the activities each week.

—Melendy Lovett, President
Educational & Productivity Solutions
Texas Instruments
Dallas

I WAS GLAD you covered the ethical aspects of the new power we've discovered. Informatics and analytics present so much power to the ingenious mathematician that with every curious step we may be unknowingly weaving a web of privacy issues, or worse.

—Saif R. Ahmed, Chairman
Elysium Analytics Inc.
Brooklyn, N.Y.

A KEY statement in the closing of the article notes that midcareer managers "still must understand enough about math to question the assumptions behind the numbers." Not so. Knowledge of math technique is useless here. It is intimate knowledge of the enterprise the math is being applied to that will prepare midcareer managers to challenge the realism of the assumptions.

Math methods applied to unrealistic assumptions cannot be expected to yield golden truths. Garbage in, garbage out—as the saying goes.

—William J. Adams
Professor of Mathematics
Pace University
New York

STEPHEN BAKER'S article makes it sound as if the business world has just discovered the industrial application of modern math techniques. In reality, this has been ongoing since Claude Guinness hired William S. Gossett, a chemist and statistician, to work at the Guinness Brewery in Dublin, in 1899. Gossett developed and published the t-test, probably the most widely used of all statistical tools. The t-test measured

how closely the yeast content of a particular batch of beer corresponded to the brewery's standard (e.g., utilization of statistics for quality control). But it is widely applied to many populations for which limited sampling data is available.

Because Guinness Brewery did not allow employees to publish research under their own names, to maintain industrial secrecy, the t-test was published under the name "Student" in *Biometrika* in

CORRECTIONS & CLARIFICATIONS

In "Math will rock your world" (Cover Story, Jan. 23), the name of the company acquired by Juniper Networks in 2005 was spelled incorrectly. The name is Peribit Networks Inc.

In the Index of Companies (Jan. 30), the ticker symbol given for Intuit should have been INTU.

In the table "Outsourcing goes global" accompanying "The future of outsourcing" (Cover Story, Jan. 30), the name of one Chinese company was misspelled. The correct name is Bleum Inc.

1908. As a result, the t-test is frequently referred to as the "Student's t-test."

If you're a consumer of Guinness, it has already been rocking your world quite some time.

—Richard V.
Davis,

I BELIEVE IN science and math, but I'm not sure that I understood the article about the use of math in business. What did not come across: Who writes the equation for better customer service? Who writes the equation for competitive pricing? Who writes the equation for product development? Who writes the equation that takes in a variety of variables in business and life? The article used IBM as an example. However, all the math it pioneered, IBM went through deep trouble until Lou Gerstner joined along! Is there an equation for Gerstner?

—Anthony T.
Hamilton Squar

A KEY problem worth underscoring is that a little knowledge of math can provide dangerous levels of confidence. For example, you suggest those "who understand probability won't squander savings on state lotteries."



ell, the real mathematicians know option value kicks in where probability goes off, so that it often is smart to buy a lottery ticket. An easy way to explain it: You won't notice \$1 less in your pocket (so it practically costs you nothing) but you really will notice \$40 million should you win.

—Jeff Buchmiller
Pilot Point, Tex.

"WH WILL rock your world," continued with "Davos will be different" (Pilot Point, Jan. 23), on India's rising inflation, and the "Business Prophet" (Special Report), on C.K. Prahalad, created the perfect storm that prompted me to write this letter. What most people don't realize is that math was invented on the Indian subcontinent thousands of years ago by forefathers, known as "Saraswati" and "Saraswati" who lived on the banks of the Indus Valley, developed basic mathematics and astronomy to build "fire altars" and determine the right time for religious rites well before the Christian era.

The Vedas and Vedantas contain references to these early works including the decimal number system and the use

“With all the math it pioneered, IBM was in deep trouble until Lou Gerstner came along! Is there an equation for Gerstner?”

—Anthony Tataseo
Hamilton Square, N.J.



of zero. Later, the Sulba-Sutras expanded on these developments, including the irrational number system, quadratic equations, the so-called Pythagorean Theorem and Pythagorean Triples, the value of pi, and other mathematical proofs that European history writers wrongfully attributed to Pythagoras, Euclid, and other Greeks.

Contrary to European-written history, arithmetic, algebra, geometry, and trigonometry were all invented and used in religious rites on the Indian subcontinent.

It's time to rewrite math history and put in India's rightful place!

—Subash Khadpe
Slatington, Pa.

NOT ALL E-GOLD USERS ARE CRIMINALS

IN "GOLD RUSH" (Investigative Report, Jan. 9), your writer paraphrased a quote from me saying that there were billions of dollars of transactions using the digital gold currencies such as e-gold and Gold-Money. The context of his story was the criminal use of digital gold in some transactions. Hundreds of thousands of people use digital gold in transactions worth billions for good business purposes. Many of these people seek to avoid the hidden tax of inflation imposed by the Federal Reserve through its paper money.

An examination of the use of Federal Reserve notes would also find them used extensively in crime, but one doesn't expect the Secret Service to raid Alan Greenspan's home.

—Jim Davidson
Global Digital Currency Assn.
New York

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Technology&You

BY STEPHEN H. WILDSTROM

It's iMac on Steroids

The most remarkable thing about Apple Computer's newest iMac is that, even after using it for a while, it's hard to tell just how different it is from the identical-looking iMac G5 introduced last fall. Don't be deceived by the similarities. Hidden in the new iMac is a processor that will let this line of Macs grow and meet the increasing performance demands of software.

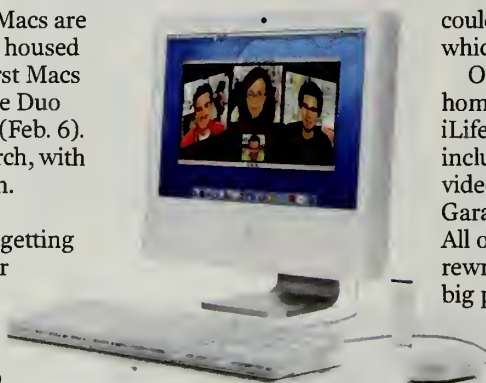
The 17-in. (\$1,299) and 20-in. (\$1,699) iMacs are all-in-one designs where the electronics are housed behind the display (photo). These are the first Macs to hit the market using Intel chips—the Core Duo processors described in last week's column (Feb. 6). A MacBook Pro notebook will be out in March, with prices starting at \$1,999, to replace the 15-in. PowerBook G4.

Apple faced a tremendous challenge just getting the new Macs to market. The Intel processor requires totally different instructions from the PowerPC chips that Macs have been built around for more than a decade. It's going to take software developers a while to convert their programs, especially if they take pains to optimize the code for performance on Intel's twin processors. For example, Microsoft has pledged to write a new, Intel-specific version of Office for the Mac, but it's not saying when it will be ready.

The key to making this transition work is a piece of software invisible to the user called Rosetta, which allows most programs written for PowerPC Macs to run on the new Intel-powered ones. Rosetta takes a toll on performance as it translates the instructions. On the other hand, the new processor is so fast that most older programs feel about as speedy on the new iMac as they did on the old. As software is rewritten, the Intel Macs will really show their speed.

ROSETTA DOESN'T SOLVE EVERYTHING, however. Some of Apple's professional software, such as the Final Cut Studio video production package, won't run on the new Macs; Apple plans to release Intel versions of these products within a few weeks. The Intel Macs also don't support the "Classic" mode used to run programs written for older Apple operating systems. But since OS X has been around for five years, there aren't all that many Classic applications still in use.

Perhaps the most serious loss is Microsoft's Virtual PC. This software allows Windows programs to run on a Mac, and because of it, many Windows users have been able to migrate to Apple, knowing that they would be able to use Windows-only applications if they needed them. So far, Microsoft has not committed to customizing Virtual PC for the Intel Mac. This



**The real
payback of
the new
Intel Mac
will be down
the road**

could be a problem for small businesses which the Mac is otherwise ideal.

One of the best things about the Mac for home use is the remarkable assortment of iLife software that comes with it. This includes iMovie HD and iDVD for editing video and creating DVDs, and GarageBand, for creating your own music. All of the iLife programs have been rewritten for the Intel processor and show big performance gains.

If the new iMac looks and feels much like its predecessor, why did Apple go to all the trouble of changing to Intel? Because the PowerPC-based systems had nowhere to go. The performance of the G5 chip in the iMac and even more so, the G4 in PowerBook laptops, couldn't increase much without a major redesign. And their maker, Intel Microelectronics, was unwilling to underwrite that. By contrast, Intel's Core Duo is the first processor in a new generation of processors that has lots of growing room. Apple is now well-positioned

to handle the ever more demanding media applications that are coming. The MacBook will probably show more impressive performance gains than the iMac because PowerBooks are actually relative weaklings.

In coming months, Apple will bring out Intel version of the Mac mini, the education-oriented iBook laptops, and professional Power Macs. The polish with which Apple managed the transition bodes well for Mac fans. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

How Fox Was Outfoxed

In December, MSNBC and CNN routed Fox News. Of course, MSNBC and CNN had spent recent months fiercely tussling for the top slot, but in December MSNBC nosed ahead to finish first. The Fox News Channel limped to a distant third-place finish, its audience roughly one-third the size of its competitors'. Did we say we were talking about TV ratings? V

are not. All these data reflect U.S. traffic at the channels' Web sites, as tallied by Nielsen//NetRating. They also reflect a complete inversion of how the cable networks perform on their home medium. (MSNBC's daily TV audience sometimes fits comfortably inside two large college football stadiums.) Could this signify that Fox News' style is less translatable to the unbridled Web than that of its straighter competitors?

The well-known rivalry between Fox News and CNN invites all manner of metaphors: red state vs. blue state, hot medium vs. cool medium, partisan tabloid vs. sober-minded broadsheet. News Corp.'s Fox News was launched in 1996 with a sharply conceived programming product that seemed specifically designed to tie its opponent in knots. For Time Warner's CNN to respond in kind would mean forsaking its serious-news DNA. But ignoring the challenger and focusing on its established bona fides left a market opening that Fox could fly a 747 through. Which it has. In early 2002, Fox overtook CNN as the cable-news ratings king, and it has not relinquished that position. (Fox's corporate sibling, *The New York Post*, employs a similar strategy against the *Daily News*, though thus far not to the same effect.) In January, the audience for Fox News' best-watched show, *The O'Reilly Factor*, was more than twice that of CNN's best-watched *Larry King Live*.

IN A PREVIOUS MEDIA ERA this would be the narrative's end, but we're not in that era. The day when the Web overtakes traditional media—when a medium's online fare generates more revenue than its original format—is years off, but big players may be glimpsing its outline in the distance. This, along with the pasting CNN continues to take from partisans on the left and right, is probably why its executives were practically giddy when told about this column. It's true that CNN.com's traffic slipped below that of MSNBC.com for several months last year, but another stat bolsters CNN's



Online: The Other Nielsen Ratings

MILLIONS OF UNIQUE U.S. VISITORS			
	DEC. '03	DEC. '04	DEC. '05
CNN.com	19.97	21.26	20.93
MSNBC.com	19.63	19.54	22.91
FoxNews.com	4.53	5.02	6.4

Data: Nielsen//NetRating

online strength. People spend more time, on average, at CNN.com than at either FoxNews.com or MSNBC.com. (Time spent on a Web site, unfortunately called "stickiness," is another key data point that media buyers weigh when making advertising decisions.)

There are many reasons Web traffic numbers sharply diverge from TV ratings. The Web may be all about splintering into models, but, especially for MSNBC.com, portals still matter. Nielsen//Net Rating finds MSN.com responsible for a large chunk of MSNBC.com's traffic. In contrast, AOL drives only a fraction as much to CNN.com. Fox News has no such portal relationship. (Wonder why Rupert Murdoch has made noises about creating a next-generation portal?)

In fairness (and balance), Fox started CNN was launched in 1980, and it has been on the Web since 1996. "They just got out ahead. Now we're climbing the ladder," says Bert Solivan, general manager of Fox News.com. But MSNBC was also launched in 1996, which, portal relationship or no, stop MSNBC.com from racking up impressive numbers. Even at current rates of growth (chances are, FoxNews.com has years to go before it will unseat either CNN.com or MSNBC.com).

FoxNews.com's growth last year suggests untapped potential, but CNN.com's audience and stickiness signify some things as well. News may be commoditizing online those in the top tier still outdo their flashier competitor (Compare the traffic of nytimes.com to other newspaper sites.) In news, the serious still counts for something. All the thinking that Web mojo is driven by sharp, partisan commentary, well, it hasn't yet helped FoxNews.com close the gap with CNN.com. Passions may run hot on the Web, but evidently there's still a place for medium cool. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia



The Story of the Plant that Never Stopped Growing

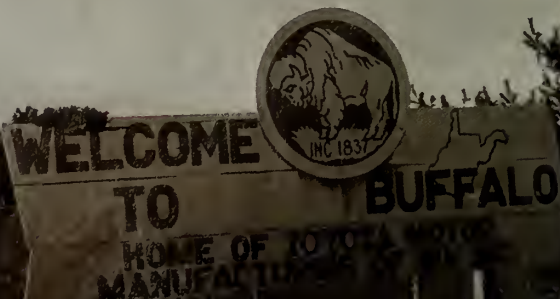


Manufacturing Facilities

THIS IS NOT A FAIRY TALE. IT'S BETTER. It's a true story about a plant that really does keep growing and growing. It's also a story about a company called Toyota. In 1996, Toyota built a plant in West Virginia, in a place called Buffalo. Soon enough, the plant was producing engines.* Then along came transmissions.

The plant grew and grew—in fact, it expanded five times in nine years!

What makes this story so exciting is that quite a few of Toyota's plants are growing. Just like the one in Buffalo. Just like the company called Toyota. It's a true story, a happy story, and best of all, a story with no end in sight.



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Jobs.....	386,000*
Investment.....	\$13B

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The Barker Portfolio

BY ROBERT BARKER

Thanks for the Dividends

Seven years ago, as *BusinessWeek* made plans for a new finance column, investor hopes were buoyant. Since then, so much has happened. Yet, incredibly, stocks now trade right where they did then. The more things change.... Now, here comes one more change: This, the 326th edition of *The Barker Portfolio*, is its last.

The column is ending its run because I've decided to begin what I (buoyantly) hope will prove a stimulating early retirement. Naturally, when I'm not pursuing some of the healthful, relaxing, and fun things I haven't managed to squeeze in often enough, I plan to spend just the right amount of time managing my personal portfolio. I am little different from so many other baby boomers, who never dreamed that they would wind up responsible for six- or seven-figure investment accounts. Yet now that we find ourselves in just that fortunate spot, the only true move is to approach the task as intelligently as we can. With that in mind, the first Barker Portfolio was headlined, "A Battle Plan for Accidental Investors." It also came with this alert: "Our best defense is to remember that Wall Street abounds with ultrasmart salespeople who are devoted to capturing our money." In this last column, I want to suggest what I see as the best offense. That would be you.

A FEW WEEKS AGO, my dad asked me a startlingly simple question: What's your best source of investment ideas? After a minute, I realized it wasn't any of the scores of pros whose names, numbers, and e-mail addresses appear on my list of contacts. Yes, many of them have been uncommonly generous in sharing their time and thinking with me. Yet I told my dad: "Public documents few people bother to study"—public companies' news reports and financial statements (8-Ks, 10-Qs, 10-Ks), quarterly updates of investment firms' holdings (13Fs), and details of corporate insiders' securities trades (Form 4s).

All are usually available at a company's Web site and, if not, at the Securities & Exchange Commission's site, through its

EDGAR service. Especially fruitful for me have been the 13Fs, which I have searched regularly for new or expanded positions held by investment managers I admire, among them Ariel Capital Management, Dodge & Cox, Harris Associates, Southeastern Asset Management, Primecap Management, and T. Rowe Price. In other words, there is no secret source. If there is any secret, it's only to check diligently, and coolly assess, public information.

The companion to this plain truth is a stark injunction leveled at me in 1984, when I began covering the Street: Fixing me with his big, dead eyes, my new boss said:

"Trust no one." In that first instance, I meant brokers, stock analysts, and institutional investors, any of whom could be expected to exploit at our expense the information they might glean from me. But I soon saw that he also meant I shouldn't trust other people's judgment—that of colleagues, friends, pretty much anyone's. As shown in *Reminiscences of a Stock Operator*, the 1923 tale of investment legend Jesse Livermore, even plugged advisers with your best interests in mind will lead you astray. After losing big by trading Union Pacific solely on the advice

of a well-connected Wall Streeter, the stock operator found enlightenment: "It was not that all I needed to learn was to take tips but follow my own inclination. It was that I gained confidence in myself." If you want to trade stocks, base decisions on your own homework.

I hope you have not been forced to learn this lesson the hard way. Even if you haven't, I offer this last, modest suggestion: Before signing on the dotted line for your new brokerage account, take a few minutes to read at least the introduction and epilogue to a book due to reach bookshelves

in April, *Wall Street Versus America* (Portfolio, \$24.95), by former *BusinessWeek* writer Gary Weiss. You will see just how alone you truly are.

Finally, I want to thank all of the readers who have written, faxed, and phoned since 1999. I am especially grateful to the many who didn't see things my way yet took the trouble to explain (in a calm manner) why. This column is now done. What won't change is your demand for *BusinessWeek's* signature brand of open-minded investment analysis—that holds no person, viewpoint, or institution sacred. ■



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JAMES C. COOPER

Why the First Quarter Could Be a Corker

Upbeat consumers and businesses will power a rebound

U.S. ECONOMY New Federal Reserve Chairman Ben S. Bernanke has likened the task of making monetary policy to driving a car while looking only into the rearview mirror. That's because the data on the economy tell policymakers where they have been, not where they're going. However, the fourth-quarter report on gross domestic product

gives a keen eye. Those numbers may well be saying more about where the economy is heading in the first quarter than they say about what was happening at the end of last year.

Real GDP growth last quarter, reported at a mere 1.1% annual rate and down sharply from 4.1% in the third quarter, was both a head turner and a head scratcher.

For many economy watchers from Wall Street to Main Street, the report indicated a slowdown, but not by that much. There was plenty of curiosities, too. Consumer spending, which was expected to grind to a halt because of slowing car sales, actually came in stronger than expected. Business investment showed up much weaker than expected, despite a surge in monthly shipments and orders for capital goods. And federal defense outlays actually took their deepest quarterly dive in six years.

The question on the minds of both policymakers and investors is whether last quarter's slowdown is signaling a cooling off in the economy in 2006 that will ease inflation worries. Many economists believe it is. And if that's the case, then the Fed can call it quits on its interest rate hikes, and investors would read that as a green light to jump into stocks and bonds without worrying that a Fed tightening could harm their portfolios.

However, a close look at the GDP report suggests the slowdown scenario is premature. Clearly, at some point, the cumulative impact of higher interest rates and a slowing housing market will begin to restrain the economy's pace—but not this quarter, and maybe not even in the first half. The data suggest that fourth-quarter economic growth may be revised higher when the government, having more complete data, takes its second look at the numbers on Feb. 28, and that the first quarter's annualized growth rate could show a strong rebound to 5% or greater.

WITH THAT ROBUST, especially if it is accompanied by further tightening in the labor markets, would very likely make the central bankers think twice about ending the steady rate increases. The Fed pushed its target rate up a quarter-point, to 4.5%, at its Jan. 31 meeting, which marked the end of Alan Greenspan's 18-year-plus tenure as chairman. Policymakers also hinted that another

rate boost at the Mar. 28 meeting is now more iffy.

The Fed's statement after the meeting pointed to the "uneven" economic data of late, and it said some further policy firming "may be needed." But that sounded as if the Fed now was less committed to another hike. Back in December the statement said more firming "is likely to be needed." The slightly softer wording appears to imply

that future rate decisions will depend on how strong the data on economic growth and inflation look between now and then.

The growth numbers may not look so tame. Consumer spending in particular promises to be a major force in first-quarter GDP growth. Note that household

A STRONGER JOB MARKET IS BOOSTING CONFIDENCE



buying last quarter was far more robust than implied by the reported 1.1% increase in real outlays. Excluding the quarter's drop-off in auto revenues from the third quarter, when incentives boosted sales, real spending grew at a 4.8% annual rate, the strongest showing in nearly two years.

MORE IMPORTANT, the rapidly improving monthly pattern of spending at the end of last quarter suggests a very large contribution to GDP this quarter. Remember the worries that consumers might sit out the holiday buying season? Well, real consumer spending posted zesty month-to-month gains of 0.9% in both November and December, far above the 0.3% average monthly gain for the full year. Those increases put outlays at a very high level going into January. If, for example, spending in January, February, and March rises 0.3% per month, real consumer spending in the first quarter would increase at a 6.2% annual rate. Even more modest monthly advances of 0.2% would push outlays up at a 5.4% clip.

Household attitudes were clearly upbeat in January (chart). The Conference Board's index of consumer confidence rose for the third month in a row, hitting its

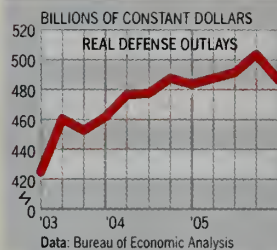
highest level in 3½ years. The rebound is remarkable for the lack of worry it implies about high energy prices. That's partly because optimism has been lifted by improving perceptions of present economic conditions, especially those in the labor markets. The percentage of households who say jobs are "plentiful" is up sharply in recent months to the highest reading in more than four years, while the percentage of those who say jobs are "hard to get" is the lowest in more than four years.

Strong labor markets and solid income growth continue to supply consumers with the wherewithal to keep spending at a hardy pace. Personal income rose smartly in each month of the fourth quarter, and even after adjustment for inflation, aftertax household earnings surged at a 7% annual rate from the third quarter. That jump partly reflects a bounceback from a hurricane-related drop of 2% in the third quarter, but it means that consumers had plenty of spending power heading into the new year.

THE FIRST QUARTER'S MOMENTUM is coming not only from consumers. Business investment also appears set to post a sizable rebound. Real outlays for equipment and software increased at a 3.5% annual rate in the fourth quarter, according to the GDP numbers, the smallest gain since early 2003. However, the monthly shipments of capital goods reported by manufacturers, which usually correlates well with equipment outlays in the GDP report, grew at a 14.9% rate (chart). That pace was a steep acceleration from the second and third quarters.

The disparity is signaling either an upward revision of the fourth-quarter GDP data on equipment outlays or a substantial rebound in first-quarter outlays—or maybe both. Indeed, forward-looking new orders for capital goods other than aircraft increased at a 10.3% rate last quarter, also a rapid speedup from the middle of last year.

A FOURTH-QUARTER DROP THAT'S SURE TO REVERSE



In addition, the trend in federal defense spending is up, not down. Real military spending dropped at a 13.1% annual rate last quarter after increasing 10% in the third quarter. Outlays can be volatile in any given quarter, but that decline was the largest since early 2000, and alone subtracted about 0.7 percentage points

from the quarter's growth rate of GDP. As first-quarter defense outlays return to their trend, the turnaround will give overall GDP an extra pop.

Throw in an anticipated rise in government spending for post-hurricane rebuilding, which did not show up big way last quarter, the need for many businesses to restock their skimpy inventories, and the continued resurgence in the manufacturing sector (below), and first-quarter GDP appears set to post a sharp turnaround after last quarter's slump.

MANUFACTURING

Full Throttle on the Factory Floor

MANUFACTURERS HAVE been on the long road to recovery the past two years. Now the sector is set to be a source of strength for the U.S. economy in 2006 as businesses increase investment spending and as manufacturers ratchet up their own capital outlays as well as hiring.

According to the fourth-quarter *Manufacturing Barometer* from PricewaterhouseCoopers, 76% of large manufacturers are optimistic about the U.S. economy, up from 45% in the previous quarter. The survey of 62 large industrial manufacturers also showed that 71% feel good about prospects abroad.

The positive views seem warranted. New orders for durable

goods were up 12.4% from a year ago in the fourth quarter, and unfilled orders surged 14.1%. What's more, the Institute for Supply Management's January index of new orders for manufacturing shows demand is holding up well.

More vigorous activity is pushing manufacturers into pumping up their own capital spending. They plan on spending 9.8% of their sales on new investments, vs. the overall average of 8.8% from the 59 large non-manufacturing companies surveyed by the accounting company.

More than 60% of manufacturers also said they plan on hiring new workers this year. The respondents, on

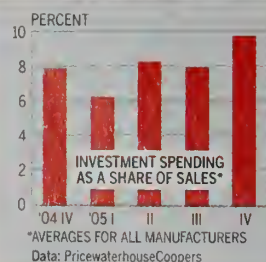
average, expect to expand payroll 2%. If that trend holds across the entire sector, nearly 285,000 factory jobs would be created this year, the first meaningful increase in manufacturing payrolls since 1999.

The outlook, however, is not without risk. Manufacturing is still reliant on foreign demand, with more than 30% of revenues coming from abroad, vs. an average of 18.8% for nonmanufacturers. Manufacturers need the euro zone and Japan to sustain their moderate economic recoveries.

Plus, two-thirds of them see oil prices as a potential barrier to growth. Compared with other sectors, manufacturers are relying more on pricing power to raise margins and offset higher costs. A spike in energy prices would not only hurt demand but also wipe out the boost to earnings from stronger pricing.

—By James Mehring in New York

Factories are gearing up to spend more





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EDITED BY HARRY MAURER



Google Falls to Earth For once, the numbers weren't mind-googling—at least not on the upside. On Jan. 31, instead of blowing past Wall Street expectations as usual, Google's \$372 million in net profits sank far below them. Revenues of \$1.29 billion came in right at the consensus guess—unfamiliar terrain for the company's number crunchers. On Feb. 1 its nosebleed stock price fell 7%, to \$401, as more than \$9 billion in market cap went poof.

Sure, much of the profit shortfall can be pinned to a higher-than-expected tax rate. But Google's stumble lends credence to skeptics who say its near-complete reliance on search ads leaves it exposed as that industry begins to decelerate. While Google has busily begun to plow into new businesses, evidenced by its January acquisition of radio advertising house **dMarc Broadcasting**, such efforts could take a long while to pay off. With the search god suddenly less divine, investors may be stricken with a loss of faith.

See "Google: Just not good enough," www.businessweek.com/go/tbw

Exxon Up, GM Down Two other titans turned in startling results. **ExxonMobil** on Jan. 30 said black ink gushed to the tune of \$10.7 billion in the fourth quarter and \$36.1 billion for 2005, the richest yearly result ever for a U.S. company. GM, in contrast, bled \$4.8 billion in the quarter and \$8.6 billion for the year, partly because of restructuring costs at both the auto maker and bankrupt **Delphi**.

See "The good news about America's auto industry," page 32, and "Exxon's silver lining has a cloud," page 36

Adios, Alan The skies didn't darken and rain frogs, **Alan Greenspan** did preside over his last Fed meeting on Jan. 31. As expected, the **Federal Open Market Committee** boos rates a quarter-point, to 4.5%, and said a March hike "n be needed." **Ben Bernanke** takes over just after growth sagged in the fourth quarter, to an annual rate of 1.1%. That quarter is likely to witness a rebound.

See "Why the first quarter could be a corker," page 46 and "Does anyone else hear snorting?" page 47

Bush's Wish List While **President George W. Bush's State of the Union** address didn't play many new tunes, business groups are pleased that he reprised some greatest hits. Among the priorities in the Jan. 31 oration: making R&D tax credit permanent, health insurance tax breaks for individuals and small businesses, liberalizing immigration and trade, and a drive to cut U.S. thirst for Mideast oil by 75% by 2025. With his job approval rating near 40% and his political capital worm-eaten, the President probably won't see much of this agenda become a reality. He did win a victory this week: **Samuel Alito** won approval to join the **Supreme Court**, albeit with more "nay" votes than any justice confirmed in a century except **Clarence Thomas**.

See "A probusiness State of the Union," www.businessweek.com/go/tbw

The Enron Trial Begins "This is a simple case. It is about accounting. It is about lies and choices," said prosecutor **John Hueston**. Responded **Daniel Petrocelli**, lead attorney for Enron ex-CEO **Jeffrey Skilling**: The defense will not "hear no evil, see no evil. This is a case of: There was evil." So spake the two sides in opening statements on Jan. 31. Skilling and ex-Chairman **Kenneth Lay** are charged with masterminding a colossal fraud. The trial, perhaps the most symbolically important to stem from the early-2000 wave of corporate scandals, is expected to last four months.

Mittal's Swift Sword The man of steel proved his mettle again. On Jan. 27, **Lakshmi Mittal** launched a \$22.7 billion offer for Luxembourg's **Arcelor**. Over 30 years, Mittal has forged his company, now called **Mittal Steel**, into the world's top producer, and he's clearly not done taking risks. He faces fierce political wrath on the Continent for need to hammer out a higher bid to triumph.

See "Family values at a steel empire," page 46, and "Mittal Steel's most daring move," www.businessweek.com/go/tbw

Cuts at Kraft You can't be too rich or too thin, so Kraft keeps trying. After a year in which sales by volume hit a record, the nation's biggest foodmaker is tightening its belt another notch. Because **Wal-Mart** and other retailers are mainly "category killers"—that is, the No. 1 or No. 2 brand in a category—Kraft has slimmed down its product portfolio by 20% over two years. Now it wants to shed 10% in 2006, and it said on Jan. 30 that it will shut up plants and trim 8,000 jobs through 2008. Maybe Kraft should sample its own **South Beach Diet** dishes?

Exubera Exuberance Investors in **Pfizer** are breathing a sigh of relief. On Jan. 27 the drug giant said the **FDA** had approved its inhaled insulin product, **Exubera**. It's the first inhaler of insulin in the U.S. that doesn't require needles, and it could rack up more than \$1 billion in sales by 2010, according to securities firm **Friedman Billings Ramsey**. The drugmaker, whose stock has been bedridden for five years, badly needed a shot of something—and got it: Shares have risen 4% since the news.

Fairmont's Fate **Carl Icahn** bagged \$116.5 million on shares he has held since November, and **Prince Alwaleed bin Talal** landed 87 trophy inns to spiff up his hotel empire. On Jan. 30, **Fairmont Hotels & Resorts**—owner of such properties as the **Banff Springs** and Toronto's **Royal York**—agreed to a \$3-billion sale to **Colony Capital** and the Saudi prince's **Investment Hotels International**. The \$45-a-share price beat the prince's earlier \$40 bid. Icahn can use his swag in pursuit of a bigger game: It will more than cover the \$6 million fee for paying former **Viacom** and **Universal** President **Frank Giordano** to head his team in a planned May proxy battle to oust **Time Warner's** board.

Burgers and Shares We're finally going to have it our way, says **Burger King**, which on Feb. 1 announced its intent to go public. The IPO documents in late February or early March. Nevertheless, publicly traded in its 52-year history, the second-largest burger chain is owned by a trio of private equity firms led by **Texas Pacific Group**. Burger King's dreams could be complicated by a nasty spat with the chain's **National Franchise Association**—a black eye for **CEO Greg Brenneman**, who had been charged to fix ties with franchisees.

Feud of the Week

He may be 80, but he's not going gently onto that good night. In fact, **Hank Greenberg's** drive to build a massive insurance empire seems to be scaring **American International Group**. The former **AIG** chief wants **C.V. Starr**, one of two private outfits he controls, to be free to sell whatever policies it likes to new customers. His old employer is trying to stop **C.V. Starr**, which writes about \$100 billion worth of premiums a year, from pursuing those ambitions. Greenberg had offered to sell it, but the parties could not agree on a price. Now, says spokesman **Howard Opinsky**, **AIG** is intent on competing, and Greenberg wants to compete. "He is already making investments around the world and has bold ambitions for **C.V. Starr** and for **Starr International**, which holds \$20 billion of contested **AIG** stock. Needless to say, lawsuits are flying. Greenberg is also battling **New York Attorney General Eliot Spitzer** and is requesting access to Spitzer's internal documents, aiming to start a probe of his own.



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UNCONVENTIONAL WISDOM

THE GOOD NEWS ABOUT AMERICA'S AUTO INDUSTRY

Sure, Detroit is hurting. But in the Sunbelt, foreign carmakers are expanding, hiring, and stoking local growth

BY DAVID WELCH AND DEAN FOUST

NANDRA BARNES KNOWS about dead-end jobs. For seven years, the single mother of three labored as a welder at an air-conditioning factory in Grenada, Miss., a gritty job that, at \$11.50 an hour, left her living paycheck to paycheck. Job security? Forget it. With every dip in orders, the factory would lay off more workers. "It seemed like there were always cutbacks," she recalls. Barnes was fearful of the day she would get the tap on the shoulder.

So when Nissan Motor Co. opened a sprawling \$1.4 billion assembly plant in nearby Canton, Barnes jumped at the opportunity and was lucky enough to snare one of the 4,200 jobs at the plant. Today, Barnes makes bumpers for Quest minivans and the four other models Nissan produces at the factory, where she earns more than \$20 an hour—a princely sum

not just for rural Mississippi but for almost any U.S. blue-collar worker these days without a union card or a college degree. Barnes, 39, even has enough money left over after paying the bills to give her three kids things that she never had—including, she hopes, a college education. "With this job I finally feel secure that I can take care of my family," she says. "I plan on retiring from here."

This uplifting auto industry tale is the one you're not hearing these days: the good news story. It has been drowned out in the past year by the relentlessly downbeat headlines coming out of Detroit. Bankrupt parts makers. Massive job cuts by General Motors Corp. and Ford Motor Co. Enough red ink to make the Rouge River truly rouge. It's easy to get the impression that domestic car manufacturing is headed toward the same inevitable extinction as American textile, apparel, and consumer-electronics production.

But the reality is more nuanced. In the past the trouble in Detroit, and the auto industry is anywhere but in decline. The growing number of Southern hamlets—Canton, Toyota, Honda, Mercedes—where other foreign car manufacturers are producing nonunionized jobs—33,000 in 2000—that pay almost as much as UAW Auto Workers earn farther north. Southerners are enjoying more choice than while the market as a whole is humming. Car sales in the U.S. inched up last year to 17 million vehicles, the third-highest

GEARING UP

AND GET THIS: EVEN as Ford and GM cut production last year, North American plants built 15.8 million cars and trucks, the same as in 2004. That happened thanks to foreign carmakers producing 4.9 million vehicles, an increase of 500,000 from 2003. Overall production is expected to reach 16.8 million by 2009, when an estimate

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just around the bend

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Pioneering a market



“With this job
I finally feel
secure that
I can take care
of my family.
I plan on retiring
from here.”

—Nandra “Nan” Barnes,
who works at Nissan’s
factory in Canton, Miss.

5.8 million vehicles will roll off foreign-owned assembly lines. Looking back, car and truck production in the U.S. has nearly doubled since Detroit's heyday in the early 1960s. "The domestic auto industry is as healthy as it has ever been," says Eric Noble, president of Car Lab, an industry consulting firm in Santa Ana, Calif. "The names on the plants are just changing."

That isn't to say there won't be pain, especially in Michigan. Hiring by foreign auto makers will only partly offset jobs lost as domestic carmakers downsize and their sprawling network of suppliers continues to go through a painful shakeout. Despite new foreign investment, the auto industry employs 200,000 fewer factory workers—about 950,000 now—than it did in 2000. Plus, much of the profit made selling cars to Americans heads back to Japan, Korea, or Germany, creating wealth overseas. And even though foreign car companies are investing in the U.S. at a higher rate, imports are still rising, from 2.8 million in 2000 to 3.4 million in 2005, says auto forecaster CSM Worldwide.

But it would be misleading to weave all of these developments into a tragedy. The reality is that many of the layoffs at the Big Three were inevitable. Even if Ford and

How the **Compensation Packages** Stack Up

While United Auto Workers make more than their counterparts at nonunionized plants in the South, the difference is not as stark as you might imagine:

PAY

Workers at Japanese-owned plants start at around \$14 an hour, vs. \$18 at UAW plants, but after three years they're both at around \$24 an hour.

HEALTH CARE

Toyota's medical plan mirrors the UAW's, with no monthly premium and co-pays of \$5 or \$10. Nissan workers pay up to 13% of premiums and up to \$20 co-pays.

PENSION

UAW members get a guaranteed pension payout of almost \$30,000 a year after 30 years. Toyota workers get a defined contribution plan that provides a lump sum based on years on the job, giving employees incentive to work beyond 30 years. Nissan has a 401(k) matching plan.

GM weren't in so much trouble, they and their parts suppliers would be cutting back. Japanese auto makers have set the pace on productivity, forcing GM, Ford, and Chrysler to get in step. In 1999 those companies all needed at least 24 hours to assemble a car. Now it's closer to 20 hours,

while Japan plants do it in 18, says Hart Consulting Inc. Troy, Mich. "That's an industry that has been in need of restructuring at all levels," says David Cole, executive director of the Center for Automotive Research in Ann Arbor, Mich. Some industry watchers say American workers are competitive, but foreign carmakers hiring them faster than ever (and winning political goodwill, to boot). In addition to Toyota's

pickup plant in San Antonio, which opens this year, the surging auto giant will open an SUV plant in Ontario in 2006. Hyundai Motor Corp. will gear up its Montgomery (Ala.) plant, with production expected to rise to 240,000 vehicles this year from 93,000 last year. And Hyundai af-

PICKUPS

Toyota Builds a Truck Even Bubba May Love

When Toyota Motor Corp. engineers visited South Texas to ask locals what they wanted in a full-size pickup, the out-of-towners got a quick education in priorities. Sure, the truck had to be big and powerful, but it also needed Texas-size brakes to stop three-plus tons of horses, hay, gear, and trailer from taking out a corral fence or barn post.

Toyota listened and learned. And at the Chicago Auto Show on Feb. 9, it will fire its boldest shot yet into the already wobbly defenses of Detroit's auto makers—taking the wraps off the first full-size Toyota pickup that's large and tough enough to win over the NASCAR and big-belt-buckle crowd.

The new Tundra, which will be built near San Antonio and arrives at dealerships early next year, spells big trouble for Detroit in the red-state Bubba-truck market, the last

reliable profit redoubt for General Motors Corp. and Ford Motor Co.

Yes, this marks Toyota's third attempt to get a work truck right. And Nissan Motor Co. beat it to market with a legit full-size truck, the Titan, by nearly three years. But according to John Matthews, a San Antonio dealer who advised on the Tundra's development, Toyota has corrected mistakes made in the current model and its '90s predecessor, the T100, both of which were too small and light to go bumper to bumper with the Big Three. Hint: It's big. How big? "When other truck owners park next to this Tundra," says Matthews, "they'll feel like they're in a solar eclipse."

To learn the truck market anew, Toyota engineers immersed themselves in South America. They hung out at NASCAR events and camped out at ranches in South Texas and Oklahoma, says Matthews. They even went to RV camps and persuaded families to let them travel along.

Toyota's gearheads had plenty of questions. What's the perfect towing solution for different-size trailers? Which dashboard materials clean up the best? How many configurations of the Tundra should Toyota offer? The answer to the last question: a lot. After all, according to the car site Edmunds.com, Ford has more than 60



Motors Corp. plans to build a 300,000-city plant at a site nearby. "Car production is changing hands, and it's going up," CSM Vice-President Michael Robinet. Expansion has a nice ripple effect, too. And every factory is an industrial park of suppliers. Toyota Motor Co. and Honda Motor Co. pack their U.S.-made trucks with 65% to 75% domestic parts, compared with 80% to 85% at Ford and GM. Officials in Mississippi estimate that the Nissan factory where Nandra Barnes works has spawned the creation of 500 supplier and support jobs that generate a combined \$500 million in economic activity. In nearby Madison, three red-brick shopping centers have popped up with a Wal-Mart, a Home Depot, and a Lowe's. "You can drive on the interstate and see it in increased activity," says Tim Coursey, executive director of the Madison County Economic Development Authority. "We have been going wide open at the seams."

GM IS HEADING HERE, TOO

IN A REGION WHERE the average manufacturing wage still runs around \$12 an hour, Nissan's jobs are coveted. Even though the plant isn't unionized, Nissan

starts workers at \$14.19 an hour, including what Nissan calls a "guaranteed bonus" of \$1.25 an hour. They top out after five years at \$23, just a few bucks less than United Auto Workers earn in Detroit.

Benefits are close to union scale, too. UAW members have the gold standard of health-care plans, paying nothing but drug and office visit co-payments. Toyota's plan is similar, while Nissan workers pay 10% to 13% of health insurance premiums and have higher co-pays. The only area where they lag behind is retirement: While UAW members have traditional pensions that kick in after 30 years of service, Nissan provides a 401(k) plan that matches 68¢ for every dollar a worker contributes, up to a relatively skimpy 5% of salary.

One myth about foreign carmakers is that they don't do creative, intellectual work in the U.S. Just in the past year, Toyota, Nissan, and Hyundai all have expanded their U.S. design and research-and-development facilities. Hyundai just opened one in Ann Arbor and staffed it with 150 tech-savvy people, with plans to

Pain remains: Foreign profits head abroad, and there's still a net job loss

expand that headcount to 1,000 by 2010.

And Detroit carmakers? They're downsizing at home. GM has been cutting its white-collar payroll by 10% a year since 2000. Its engineering staff has been reduced from 19,000 then to 12,000 now. Fortunately, top researchers and designers have other places to go. Just ask Joel Piaskowski,

chief designer at the Hyundai Motors Design & Technical Center in Irvine, Calif. Sitting at Hyundai's booth at the Detroit auto show, Piaskowski says he left his job at GM after designing the new Buick Lucerne sedan to join Hyundai—with a nice promotion. He left Detroit, he adds, to be part of a company that is thriving. Piaskowski's new job gives him the freedom to design more types of vehicles. "Other companies are burdened by cost and overhead. We can do things they can't do," he says. While the upheaval in the car industry has shaken up the majority of Piaskowski's former co-workers at GM, it has left him in a better position than ever. ■

—With Coleman Cowan in Atlanta

ions of the F-Series for customization-copy truck buyers. And Chevy lists 46 uses of the Silverado. The current Tundra has just 18.

Image was a matter of considerable

import, too. Toyota has a great reputation for quality and reliability. But the macho image that has long endeared Ford to Texas ranchers? Um, no. "You've got three generations of truck-buying families here

with Ford blue ovals tattooed on their foreheads," says Matthews. Spy shots of camouflaged Tundras on test tracks, as well as the Toyota concept shown two years ago at the Detroit auto show, reveal an aggressively sculpted hood akin to the Dodge Ram and a more muscular look than the category-leading Ford F-150.

And while Matthews wouldn't divulge the Tundra's specifications, he says that "Toyota realized it needs to be the best in class." Likely translation: The Tundra will top the 305-horsepower engine and 9,500-pound tow limit that come standard with the Nissan Titan. Plus, Toyota's new truck will feature a living-room-quality interior and plenty of storage options for road warriors.

Of course, it's no coincidence that Toyota chose San Antonio truck country to manufacture the

new Tundra; 12,000 new jobs builds a lot of goodwill—not to mention a steady stream of newspaper ads reminding consumers that Toyota has spent billions of dollars constructing plants in pickup-centric states like Kentucky, Indiana, and West Virginia.

And to make doubly sure that people got the message, Toyota in 2003 persuaded NASCAR to count the current Tundra as a qualified American truck. That finally won Toyota a slot in the Craftsman Truck Series, which features drivers racing modified pickups. You could almost hear the gnashing of teeth in Detroit.

Ford President Mark Fields has said that Toyota is "desperately trying to cast itself as an American brand." But patriotic fealty to Motown pickups is fading fast. In Janesville, Wis., home to a GM SUV plant, sales at Hesser Toyota, including Tundras, have been up 30% two years running, says General Sales Manager Phil Bouland. And some of those customers have been GM employees and their families. Buying Toyotas, says Bouland, has become "more acceptable than it was three or four years ago."

All Toyota needs to do now, it seems, is build the Tundra sufficiently big and rugged—and they will come.

—By David Kiley

Shifting Gears On Big Trucks

Toyota's third try at a full-size pickup truck, the 2007 Tundra, should help it crack Detroit's last stronghold

LF-TON FULL-SIZE TRUCKS	MARKET SHARE OF ENTIRE FULL-SIZE TRUCK SEGMENT	
	JAN. 2004	JAN. 2006
Toyota Tundra	4.5%	5.0%
Ford F Series	22.3	22.3
Chevy Silverado/GMC Sierra	24.9	27.7
Dodge Ram	12.2	10.5
Nissan Titan	3.4	3.4

Data: Edmunds.com

THE TUNDRA CONCEPT Aimed at being "the best in class"





OIL PATCH

EXXON'S SILVER LINING HAS A CLOUD

High energy prices fuel profits. But they also make it harder to tap new supplies

BY PETER COY

IT WOULD BE AN EXAGGERATION to say that oil company executives don't like high oil prices. But only a small exaggeration. The celebrating is certainly muted in Irving, Tex., where on Jan. 30 Exxon Mobil Corp. reported the biggest annual profit in U.S. history: \$36 billion. "We don't get excited in the highs and we don't panic in the lows," a spokesman says.

Hard to believe, but oil at more than \$60 a barrel creates big headaches for Big Oil. It angers both customers and Congress, which once again is making noises about a windfall profits tax. Shareholders aren't especially grateful, either, seemingly operating on the belief that any idiot could make good money selling oil at the highest prices ever. At around \$62, ExxonMobil's share price is no higher than it was last March.

But the biggest problem with costly oil is that it makes it tougher to line up new supplies. Countries that sit on lots of oil—such as Iran, Kuwait, Libya, Russia, Venezuela, and Nigeria—drive harder bargains with the supermajors like ExxonMobil when oil prices are high.

Oil-rich nations are reluctant to part with irreplaceable natural resources at prices below where they stand now. The Western oil companies want to cut deals on the assumption that oil will drop back to \$25 or \$30 a barrel. But that's hard to argue when the oil for delivery in December, 2012, is trading at \$64.

When the supermajors can't negotiate access to new fields, their production drops. This isn't just hypothetical: The most important fact in ExxonMobil's quarterly earnings report was that oil and natural gas production fell 3.6% in 2005 from 2004, continuing a five-year downtrend. (Excluding onetime factors such as hurricanes, it fell 1%.) If the company can't ramp up output by getting access to new fields, it will be a cash cow slowly going dry. Not a good prospect.

Fortunately for ExxonMobil and for consumers, it appears that its production is indeed rising again. Analyst Daniel L. Barcelo of Banc of America Securities in

AFRICA Oil-producing nations are driving a harder bargain

New York estimates that its output will grow around 5% in 2006, with increased flow from

Angola, Nigeria, Azerbaijan, the U.S. Gulf of Mexico, and Norway.

It's a struggle, though. Big Oil's negotiations over production-sharing deals have gotten seriously sticky. Libya opened itself to foreign investment in September, 2003, after it renounced terrorism and weapons of mass destruction, but it wasn't until last year that it finally came to terms with its erstwhile U.S. partner. The expected price of crude was a big part of the hangup. Exxon has been battling Venezuela, led by leftist Hugo Chávez, who insisted that all foreign oil companies convert their operating contracts into joint ventures with the government. In December, Exxon sold its stake in a Venezuelan oil field rather than meet the country's demands. Even Britain whacked the oil majors last year, increasing taxes on North Sea oil.

PILE OF CASH

BEHIND THE skirmishes is the escapable fact that countries awash in revenue simply don't need the dollars pocketed by Western majors as much as they did in 1998, when oil touched \$10 a barrel. Meanwhile, today's high prices are attracting competition for deals from smaller rivals, which tend to accept smaller profit margins. And costs are rising up along with prices. The new oil is hard to reach or of low quality, like the gunk in Alberta's "tar sands."

Oil is like the big market in that a price rise, while welcome, creates reinvestment headaches. Bondholders make killing when bond prices rise, but when the bond matures they're stuck with a pile of cash that they're forced to reinvest at lower yields. Ditto for oil executives when oil prices rise. ExxonMobil has a hoard of \$33 billion in yielding cash in spite

of paying \$7 billion in dividends and buying back \$16 billion of shares last year. "It gets harder every year" to put money to good use, says analyst Jacques Rousseau of Friedman Billings Ramsey. Oil shareholders know what the oil executives have done for them lately. They're asking a tougher question: "What do you do for me next?" ■

THE STAT

-3.6%

The change in ExxonMobil's output of oil and gas from 2004 to 2005.

Data: Exxon Mobil Corp.

DOES ANYONE ELSE HEAR SNORTING?

A handful of analysts see a '90s-style bull market if the era of rate hikes ends

BY MARA DER HOVANESIAN

THE NETSCAPE IPO AND Windows 95 aren't coming back. But a growing number of investment strategists think stocks might be on the verge of 1995-like returns—if new Federal Reserve Chairman Ben S. Bernanke plays things right.

A few months ago it looked as though Bernanke would have a monster of a job on his hands. Core inflation figures were rising, housing was showing signs of cooling, and gross domestic product was slowing at a strong 4% clip. The Fed would have to raise interest rates long before 2006, the thinking went, to slow the economy, pop the housing bubble, and establish Bernanke's bona fides as an inflation fighter. It wasn't a good scenario for stocks, which usually perform poorly when rates are rising (chart).

Things may be changing. The long campaign of rate hikes, which sent the federal funds rate from 1% in June, 2004, to 5.25% now, seems to be working: Cooling began to cool in the fourth quarter, while core inflation slowed. In fact, the rate hikes might be working a little too well, judging from the weak third-quarter gross domestic product reading of 1.1% and some corporate earnings misses.

Bernanke's path, say bulls, looks clear now. Many economists expect the Fed to keep raising rates soon, perhaps after one or two more quarter-point hikes.

What could set up the soft landing Edward E. Yardeni, chief investment strategist at Oak Associates Ltd., has been waiting for. In late 2004, Yardeni began making the case that the second half of the decade would mirror the second half of the 1990s. The parallels between the first halves of both decades, he said, are

unmistakable: a recession, a slow recovery, a divisive election (1994 and 2004), and interest rate hikes that cooled stocks. Once an economic soft landing takes place and the hikes end, he posited, stocks will rise, just as they did in 1995.

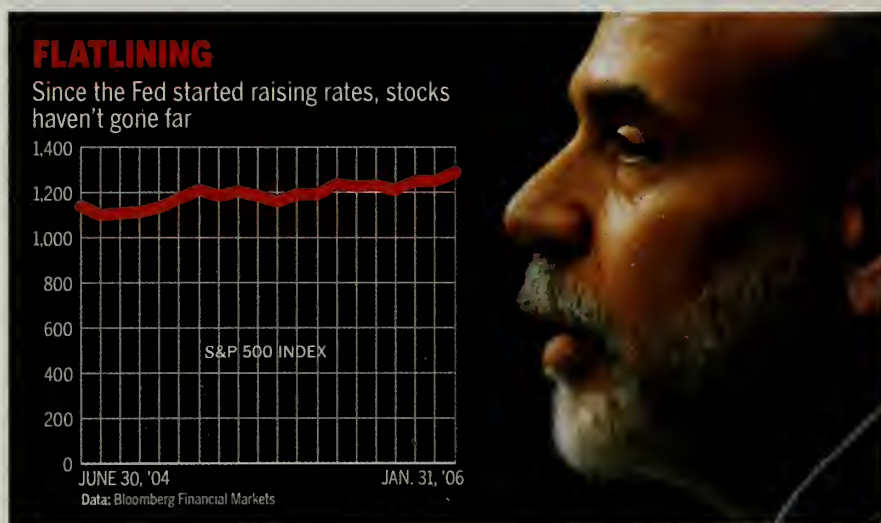
Market watchers thought Yardeni was crazy. The tech boom is over, they scoffed, and geopolitics and energy prices are now a

says money has to go somewhere." His bets: stocks and commercial real estate.

History is on the bulls' side. The Fed has waged five tightening campaigns since 1983. In four of them, the market gained an average 15.5% in the following 12 months. The exception was May, 2000. But stocks were wildly overvalued then, note the bulls, with a forward price-earnings ratio for the Standard & Poor's 500-stock index of 24, vs. the historical average of low double digits and today's 15.

CASH TO BURN

THE OPTIMISTS also point to corporate coffers. Despite a few high-profile fourth-quarter earnings misses, fourth-quarter operating earnings for the S&P 500 are set to post a 12.6% year-over-year gain, the 15th consecutive quarter of double-digit growth, a record. The extended run has given companies record cash to fuel acquisitions, capital spending, dividends, and share buybacks. Those activities should protect their stocks when earnings growth decelerates to the historical range of 8% to 10%, say the bulls.



BERNANKE

Now that inflation has slowed, his path looks clearer

the '90s, an unlikely scenario now.

But a few big-picture types are coming around to the view that 2006 will see the next leg up in the stock market. Joseph McAlinden, chief investment officer of Morgan Stanley Investment Management's global equity group, says stocks are set to surge, albeit with some volatility. "Stocks will be the best-performing asset class," he says. Neal M. Soss, chief economist for Credit Suisse First Boston LLC, agrees. "A flow-of-funds argument

constant drag on investor confidence. Plus, long-term interest rates fell precipitously in

Thomas McManus of Banc of America Securities LLC published a research report on Feb. 1 picking apart the 1995-2006 argument point by point. Others note that a strong first-quarter GDP report could force Bernanke to keep his foot on the brake longer than the bulls think (page 27). Richard Bernstein, chief U.S. strategist at Merrill Lynch & Co., says Bernanke may well go too far: "The Fed has never known when to stop tightening."

One thing is clear: Stocks, stuck in a narrow range since late 2003, are due for a move up or down. What they need, says Brian Gendreau, a strategist at ING Investment Management, is a catalyst—like, say, the end of rate hikes. ■



REYES He's trying to restore his reputation

SILICON VALLEY

STUNG BY STOCK OPTIONS

As the government investigates Brocade and ex-CEO Reyes, he may sue the board

BY PETER BURROWS

AFTER GREG REYES suddenly resigned as chief executive of Brocade Communications Inc. a year ago, the reputation of the swashbuckling onetime billionaire immediately went from gold to mud. The reason: His ouster came just weeks after Brocade announced options accounting irregularities that required a restatement of earnings. But now, more than his image is on the line. Three sources tell *BusinessWeek* that the Securities & Exchange Commission is likely to bring civil charges against him in the coming weeks. The Justice Dept. is also investigating a criminal case. "I'm scared," says Reyes.

He should be. Twice in the last year, Brocade admitted that it incorrectly accounted for options it granted new hires. The probe comes when the government is investigating many former tech high-fliers for similar practices. Predicts one

tech lawyer, "Someone is going to get the opportunity to be the Martha Stewart of options pricing, and Brocade is a leading candidate."

But Reyes, who loves to hunt big game, plans to fight back. And he plans to do it in a way that could put a spotlight on Brocade's board—including Silicon Valley super-lawyer Larry W. Sonsini, who left the board soon after Reyes' departure. The 43-year-old Reyes insists he did nothing to enrich himself and says the mistakes were primarily paperwork errors by a former human resources executive. Even if he had approved the practices, he says, it would have been within his authority, given the sweeping powers the board gave him in 1999. Now, he argues, seven current and former directors are scapegoating him to minimize their own liability. "What better way to do that than to throw me under the

bus," he says. Neither Brocade, Sonsini, the SEC, or the Justice Dept. would comment for this story.

Reyes was planning to file a civil suit against the directors on Jan. 24, before Brocade persuaded him to hold off by tending the statute of limitations on potential wrongful termination charges. And he's also mulling a shareholder's lawsuit alleging that the investigation by the board's audit committee did far more harm to investors than the alleged accounting miscues. In particular, he says, the investigation was in the final stages of selling Brocade to Cisco Systems Inc. for \$9 a share in November, 2004. Brocade makes data storage gear and was one of the hottest stocks of the Net bubble, with a one-time market cap of \$24 billion. But talks with Cisco stalled after the board disclosed the investigation. Other insiders say that Cisco got cold feet after finding the accounting irregularities on its books but confirm that Reyes' departure months later further diminished its interest. Cisco declined to comment.

Much of Reyes' ire is saved for Sonsini, a power broker who has advised everyone from Steve Jobs to Google during a storied 40-year-career. Reyes says Sonsini urged the board to make Reyes a "committee of one" to dole out options as he wished in 1999. The next he heard from the board, he claims, was after disgruntled former employee threatened to file a whistleblower suit in 2004 alleging improprieties related to options.

After an investigation, Reyes says Sonsini persuaded him to resign because the evidence pointing to him was "overwhelming and conclusive." Only after Reyes had seen the evidence and, under pressure, tried to rescind his resignation did Sonsini reveal that Brocade's outside auditor had refused to certify Brocade's financials with Reyes as CEO, Reyes says. His argument: that member of the board overstated his role in order to deflect the auditor's attention from themselves.

With possible SEC charges looming, Reyes is pressing his demands. He says Brocade he would drop talk of lawsuits

Reyes cites paperwork errors by a former HR executive

it publicly exonerates him and puts him back on the board and pays him a rich consulting package it rescinded last summer. But if the government's case is as strong as some insiders close to Brocade hint it is, this big-game hunter may be feeling like the pursuer and not the prey. ■

A SOTHEBY'S FOR FOR INVENTORS

Patents are going up for auction—and some big-name companies will be selling

BY MICHAEL OREY

LAST YEAR, DEAN BECKER, an avid collector of classic cars, was thumbing through a catalog for an automobile auction. Why not sell patents the same way, he thought. This April, Ocean Tomo, a

where Becker is a managing director, will do just that. It has lined up a British auctioneer to take the podium at The Ritz-Carlton in San Francisco and sell off rights to everything from earth-imaging technology to shrink-wrap.

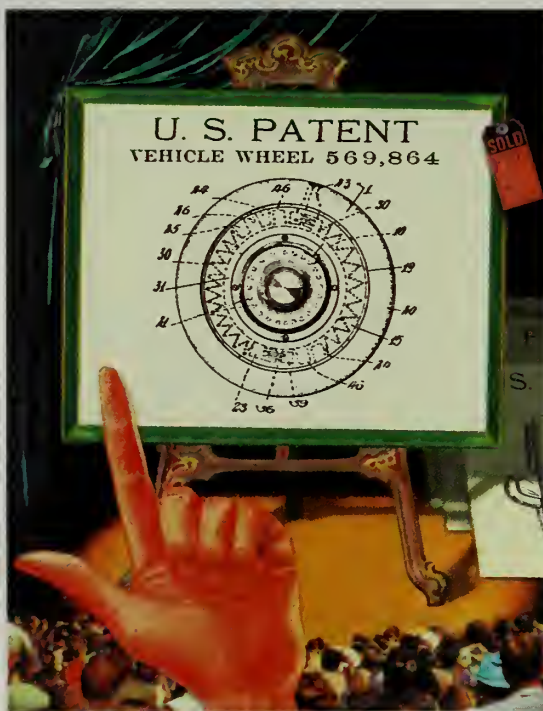
Think of what eBay Inc. did for the junk in people's garages, and you get an idea of what Becker's idea could mean for intellectual property. "Right now what you've got is a marketplace where nobody knows what the asset is worth," says David Kappos, an assistant general counsel at IBM who manages patents.

Chicago-based Ocean Tomo is part of a new industry of firms that want to cash in on patents. Traditionally, patent deals have been shrouded in secrecy and burdened by steep transaction costs. The primary method of extracting value, beyond selling a product based on an invention, has been licensing patent rights. But lingering negotiations are often arduous and need to be backed up by a willingness to litigate, which is expensive.

Auctions could help foster "the emergence of a liquid market" for buying and selling patents, says Kappos. So far more than 1,200 patents have been submitted to Ocean Tomo for sale from such companies as T&T, BellSouth, American Express, and Kimberly-Clark.

Auctions become a regular feature of the patent world, they would help establish a marketplace. "I see this as a great opportunity [as] an independent inventor to really get exposure to a large base of companies that could commercialize my

patents," says William L. Reber. Now on his own after working as an engineer for Walt Disney Co. and Motorola Inc., Reber is the creator of 48 patents he's putting up for sale at the auction, which takes place on April 5 and 6.



Going, Going...

Here's a look at some of the patents being put up for sale in the Ocean Tomo auction

KIMBERLY-CLARK	BELLSOUTH	3COM
4 PATENTS	20 PATENTS	1 PATENT
Lithium ion batteries, shrink-wrap, sterilization technology	Search engines, wireless services, voice messaging	Flash memory

Kimberly-Clark Corp. will sell patents on a new shrink-wrap that it has decided not to commercialize, and BellSouth Corp. will auction off 20 patents in areas no longer part of its core business, such as search-engine technology. "We think this is a good avenue to explore," says Bill Hartselle, a managing director in BellSouth's patent marketing unit.

MARKETING STUNT?

PATENTS FROM EACH seller will be grouped into lots when they relate to a common area. Some lots will include additional material such as prototypes of products, inventor notebooks, and, in one case, 80 hours with the inventor to aid in transferring expertise. Ocean Tomo—a name combining a legal acronym with the Japanese word for friend—will get 25% of the sale price.

It's the ambition of Ocean Tomo's co-founder and CEO, James E. Malackowski, to turn his firm into an "intellectual-capital merchant bank" offering a range of products and services, including strategic advice for mergers and acquisitions of patent-rich companies, patent appraisal, and insurance against infringement claims. The auction is integral to that vision. It is, he says, the "foundation for establishing patents as an investment asset class." In his view, patents are in the same spot as real estate was decades ago, before it was connected to the Wall Street spigot by such things as real estate investment trusts and mortgage-backed securities.

Some see the upcoming auction as little more than a marketing stunt. And Malackowski certainly has a propensity for promotion. Two firms he was affiliated with before founding Ocean Tomo in 2003 raised questions about items in his Web site résumé that describe investment work he had done with them. Malackowski says the résumé was accurate, but modified it following questions from *BusinessWeek*.

Still, many see Malackowski as a visionary. "We've been talking about things like new ways of monetizing patents, new ways of leveraging [intellectual property]," says Kappos of IBM. "Ocean Tomo is right there inventing the future." ■

HOLLYWOOD

JAMES CAMERON'S GAME THEORY

Get kids hooked on a multiplayer game, then show them the movie

BY BURT HELM

JAMES CAMERON HAS transported film audiences to worlds inhabited by carnivorous aliens, time-traveling assassins, and passengers on an ill-fated ocean liner. Now the director of *Aliens*, *The Terminator*, and *Titanic* is trying something different. Holed up at his home in Santa Barbara, Calif., Cameron is working on the screenplay for *Project 880*, which he describes as “completely crazy, balls-out sci-fi.” If it gets produced, it could be the first major Hollywood project that audiences will experience first as a multiplayer game on the Net, and only later on the silver screen.

Movies with game tie-ins have been around since the days of Atari, but the games usually follow the plot. With *Project 880* (a working title), which is still at least two years off, gamers could be exploring Cameron's virtual world for weeks before they head for a theater to learn the story. And the game could spawn whole communities of diehards such as those who spend every waking hour immersed in *EverQuest*, *World of Warcraft*, and other massively multiplayer online games, known as MMOGs. “So much of literary sci-fi is about creating worlds that are rich and detailed and make sense at a social level,” Cameron says. “We’ll create a world for people and then later present a narrative in that world.”

What would an MMOG bring a mogul? Cash, for one thing. *World of Warcraft*, a

J.R.R. Tolkien-inspired fantasy game from Vivendi Universal that boasts 5.5 million users worldwide, brought in about \$300 million last year in sales and subscriptions, figures David Cole, president of game researcher DFC Intelligence. And while MMOGs make up just 7% of the \$28 billion game market, they may be the most addictive niche. A Stanford University researcher who surveyed 3,000 MMOG denizens found that the median player was immersed for 20 hours a week, vs. seven to eight hours for gamers at consoles.

SCI-FI REALITY SHOW

CAMERON HAS MORE than a passing interest in simulation and next-generation games. A former physics major at California State University, he once served on the board of NASA. Aiming to shoot all his future films in 3-D, he has helped pioneer a whole suite of 3-D cameras, tools to capture actors' performances and import them into simulations, and various post-production techniques. Cameron now sits on the board of Multiverse, a startup that helps developers create their own games in return for a cut of the subscription revenues. “You’re seeing what hundreds of thousands of people in this game environment can create,” he says.

Other big directors are glomming onto MMOGs. Imagine Entertainment, the company run by Ron Howard and Brian Grazer that created the TV show *24*, has teamed up with producer Jim Banister, *Halo* creator Alex Seropian, and others to develop



THE DIRECTOR is aiming to shoot all future films in 3-D

a sci-fi reality show called *XQuest*. If it flies, contestants will occupy a cramped spaceship-like module for a month. flight simulators will subject them to rocket-like conditions, including six G thrust. Players will ply the galaxy waves following the rough contours of a planet. Outside the ship, online gamers will track the crew's mission and ultimately become their own PC-based spaceships to compete with contestants in shared, simulated space. The next season's cast, according to theory, is chosen from those who spend the most skill playing the game at home.

For studios, MMOGs may not be more than a hedge against a fickle box office. Online gamers are famously choosy. Most games fail to bring in more than 20,000 players, yet good titles can cost \$10 million to \$20 million to develop. The player pool is mostly boys and young men. The medium has genre limitations: Don't look for MMOGs based on *Brokeback Mountain* or *Walk the Line* anytime soon.

Still, for the growing hordes of gamers, MMOGs may be ripe for crossover. “You are exploring the interaction of technology and the human imagination,” says Cameron, “and play it out in a highly competitive, paced interaction.” Movies can show what imagination looks like. MMOGs can show how it feels on the inside.

THE STAT

20

The median number of hours players spend online each week immersed in massively multiplayer games

Data: Stanford University's Daedalus Project

BusinessWeek online Oscar-winning film director James Cameron discusses creating MMOGs at businessweek.com/extra

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EDITED BY RICHARD S. DUNHAM

Lobbyists: Whose Calls Won't Be Returned

CONGRESSMAN REPRESENTATIVE TOM DOWNEY is crying foul over Capitol Hill's post-Abramoff push to change the rules of influence peddling. Now a lobbyist for blue-chip clients ranging from Time Warner to Fannie Mae, the Democrat from Long Island is a regular in the House gym—a privilege he may soon lose.

The result, Downey says, will be a lot of borbasketball: "If they ban former members [from the games], who's going to pass the ball?" Bada-bing. Toss in a possible prohibition against dining out with lawmakers, Downey adds, and "the former members will all be fat because they're not allowed to eat out anymore. And the current members will all be skinny because they're not allowed to eat lunch." Bada-boom.

The joke: Downey and his fellow lobbyists are bracing for the backlash from the Abramoff scandal. But while Washington lobbyists may all look alike from behind the Beltway, they actually come in many varieties—and the changes will hit some, like Gucci Gulchers far harder than others.

Dangerous Calls

ALL LAWMAKERS-turned-lobbyists such as Downey or Joe Livingston, once a powerful Louisiana Republican, following the lead of House Ethics Committee Chairman David Dreier (R-Calif.) and Peter Dennis Hastert (R-Ill.), the House voted on Feb. 1 to ban ex-members who are lobbyists from the floor and gym. Loss of that easy, informal access to members could reduce House alumni's influence rates.

Even more diminishing value are for Hill staffers whose primary—and sometimes sole—qualification is their ability to get the old boss on the phone, pronto. The "access lobbyists" will be viewed with suspicion by lawmakers who know that ready ex-staffers can do them more harm than good. Already, one firm, Alexander Strategy Group, founded by longtime aide to former House Majority Leader

Tom DeLay (R-Tex.), has shut its doors.

Another breed of influence peddlers specializes in wrangling specific projects from congressional appropriators. This bacon patrol brings billions of dollars to favored companies and communities via more than 15,000 "earmarks," or targeted projects, each year. Now, pork-busting Senator John McCain (R-Ariz.) and his House allies want to turn off the pipeline. That would endanger specialty firms such as Van Scoyoc Associates, which won money in 2005 for clients ranging from the Alabama Institute for the Deaf & Blind to Raytheon. President Stu Van Scoyoc concedes that the changes could hurt, but says: "The people who will

be successful are the people who do it best."

Reform could produce winners, too. Hill offices will depend more than ever on wonk lobbyists, whose power rests on their mastery of arcane laws and regulations. "For those lobbyists who immerse themselves in the substantive details, this won't be a negative thing," says Scott Segal, an energy specialist with law firm Bracewell & Giuliani.

Trade associations will benefit as well. Their wish lists are clear, unlike those of hired-gun lobbyists with long client rosters and hidden agendas. Lawmakers can easily defend their meetings with industry groups, especially those with members in their districts.

But the best-positioned of all in the new Washington? Ethics attorneys. "This will create a new industry of compliance lawyers," predicts one Republican lobbyist. For legions of lobbyists who suddenly find themselves out in the cold, that could be a promising career path. ■

—By Eamon Javers



ABRAMOFF
Dark days for fellow hired guns

CAPITAL INSIDER

MAKING MISCHIEF ON WIKIPEDIA

Campaign dirty tricks have found fertile new ground: Wikipedia. Congressional staffers have discovered that anyone can tinker with entries in the online encyclopedia, and they've inserted or deleted more than 1,000 embarrassing items on their bosses'—or foes'—write-ups. Representative Richard Pombo's entry was edited to include the California Republican's ties to disgraced lobbyist Jack Abramoff. An anonymous detractor inserted the false claim that Tom Coburn (R-Okla.) was voted "most annoying senator" by his peers. And the bio of Representative Marty Meehan (D-Mass.) was scrubbed to remove mention of his broken term-limit pledge.

Alerted to the mischief by a reporter for the *Lowell* (Mass.) *Sun*, Wikipedia has blocked access from House accounts three times, most recently on Jan. 28. Wikimedia Foundation President Jimmy Wales has asked the Wiki community to solve the vexing problem.

HEY! DON'T TOUCH THAT HEALTH PLAN

Call it Social Security redux. The AFL-CIO is putting the leaders of a dozen banks on notice that it will hammer them if they get behind President Bush's plan to boost health savings accounts. The labor federation hopes for a repeat of 2005, when its pressure kept some financial firms from stumping for Social Security private accounts. The targeted banks have founded a lobbying coalition to push for the health accounts. But unions contend that replacing employer-provided insurance with HSAs will undermine the financial security of workers—who are also bank customers.



ROBUCHON Opening eateries in Hong Kong, New York, and London

RESTAURANTS

THEY CAME, THEY COOKED THEY CONQUERED

Star-studded French chefs are building global empires

BY CAROL MATLACK

INSIDE THE RESTAURANT JOEL Robuchon at The Mansion, guests dine beneath a crystal chandelier on confit of lamb and noix de Saint-Jacques. It's what you'd expect at a Paris establishment run by the Michelin-starred chef Robuchon. But step outside and you're on the Las Vegas Strip, not in the City of Light. Robuchon opened The Mansion, and a more-casual eatery, L'Atelier de Joël Robuchon, in the MGM Grand Hotel & Casino complex last September. And he's not stopping there. By summer he expects to open three more restaurants, in New

York, London, and Hong Kong. "We've received many other proposals, but we can't develop them all," the 60-year-old chef says.

Robuchon is one of a handful of French chefs who are building world empires, stretching from the American West to the Far East. These masters are marketing themselves as global brands, betting that sterling reputations will draw customers into restaurants, even if the chefs themselves are rarely on the premises. Alain Ducasse, the most prolific of the group, now runs 21 restaurants and five hotels on three continents.

Why are these chefs venturing so far

afeld? One reason is the emergence of new culinary hot spots, where wheeled customers are willing to pay \$400 and up per person for a fine meal. Las Vegas is one. The gambling oasis is home to several world-class French restaurants, featuring such big names as Robuchon, Ducasse, and Jean-Georges Vongerichten, with Guy Savoy joining them soon. It's an ideal spot, really: There are plenty of high rollers. And, Gamal Aziz, president of MGM Grand

BusinessWeek online For a slide show of French restaurants opening up around the world, go to businessweek.com/extras

el & Casino: "Because of the short
e people spend here, they want to be
e they have a memorable evening."

NAME'S THE THING

ANS, ALREADY AVID consumers of
ich luxury goods such as Louis Vuit-
bags and Chanel perfumes, are now
veloping a taste for French cuisine. At
t five restaurants run by top French
s have opened in Tokyo in the past
years. Still others are opening up in
g Kong, Shanghai, Bangkok, and Sin-
ore. "Robuchon's name is the reason
here," says Kiyomi Yamane, 36, over
h at L'Atelier de Joël Robuchon in
o's Roppongi Hills shopping com-
"I knew Robuchon wasn't going to
ack there in the kitchen. That's the
re of the business."

Another reason for the global push:
te cuisine has fallen on hard times in
ce. Corporate belt-tightening has
big dent in expense-account dining
uris restaurants and increased their
nce on foreign tourists. Overhead is
because of the large staffs required
epare and serve complicated meals.

In France, a *gastronomique* restaurant is
to make prof-
al," says Robu-
in an inter-
at his spartan
an office.

That's why many chefs are opening
formal dining venues. Robuchon
od his Michelin-starred Paris restau-
an in 1996 and in 2003 opened L'Atelier
e Joël Robuchon, a Paris establishment
he guests can watch the kitchen staff
oy while seated at a counter, sushi-bar
yl. The formula works outside of
rate as well. Robuchon has opened two
h Atelier restaurants and is set to add
vo more this year. A typical Atelier meal
ost \$75 to \$95, including wine, less
half the average tab at his swankier
staurants. Even so, Robuchon says the
eters are far more profitable. Of
ucasse's 21 restaurants worldwide, only
re serve up traditional high-end cui-
ne. His others are less formal, such as
oon, which now operates in six cities
on London to Hong Kong and offers
ecorice dinners for just over \$100.

N doubt these chefs can whip up a
leable *amuse-bouche*, but can they
arge a global business for the long
au. Operating a top-notch restaurant
ques flawless coordination and atten-
on detail. Many chefs stumble when
ey try to open more than one. Remem-
occo DiSpirito, the 2003 celebrity
ework chef featured on the reality TV

show *The Restaurant*? He's
no longer in business. "It
can only work if the chef
gives away responsibility
in the kitchen," says David
Rosengarten, a New York-
based writer who edits a
monthly newsletter on
food, wine, and travel.
"Other things become
more important: selection
of ingredients, selection of
personnel, teaching. Alain
Ducasse has done it, but not everybody
has this set of skills." Ducasse also has
some help: His business partner Laurent
Plantier has an MBA from Massachusetts
Institute of Technology's Sloan School of
Management.

Among the required competencies is
military-like planning. More than a year
before each restaurant opens, Robu-
chon's advance teams scope out suppliers
of everything from strawberries to milk-
fed veal. To ensure consistency in the

Haute cuisine has been hurt by expense- account cuts in France

kitchens, he employs veteran
chefs, most of whom have
worked with him in Paris.

Like most of his fellow
empire-builders, Robuchon
either co-owns his restau-
rants with local partners or
operates them under con-
tracts with hotels or other
owners. The contracts often
specify the star chef must
cook a certain number of
days in the restaurant.

All of the up-front sweat can make the
difference between a pick or a pan from
some influential critic. "We know there is
a risk, especially when you are going to
America, where the press can be very
honest," says Robuchon. Lucky for him,
The Mansion has gotten rave write-ups
from *The New York Times* and *Los Angeles
Times*. Ducasse, on the other hand, en-
dured a barrage of criticism for the
stratospheric prices at his restaurant in
Manhattan's Essex House Hotel after it

opened in 2000. It is now con-
sidered one of the city's premier
dining spots and was one of
four to receive three stars in the
newly published *Michelin Red
Guide to New York City*.

Such success stories encour-
age others to jump on the band-
wagon. Guy Savoy, a Michelin-
starred chef who runs five Paris
eateries, is set to open his first
overseas restaurant in May, at
Caesars Palace Hotel in Las Vegas.
Savoy admits he was skepti-
cal when the hotel first ap-
proached him in 2003. But he
changed his mind after visiting
Las Vegas and seeing the pletho-
ra of French restaurants and
boutiques. "French prestige will
be all around us," he says.

Could global expansion, far
from diminishing haute cuisine,
actually improve it? Robuchon
says his travels have inspired
him. He admits he was initially
horrified to see Chinese chefs
rinsing shrimp under water until
the flavor washed away. But he
noticed that the rinsing changed
the texture, and that led him to
try new techniques. "There is an
exchange of ideas that isn't possi-
ble when you are working only in
the kitchen," he says. Sounds like
this latest French export is more
than just a flash in the pan. ■

—With Ian Rowley and
Kenji Hall in Tokyo



A Table in Each Time Zone

The upper crust of French chefs is
rolling out restaurants worldwide

ALAIN DUCASSE His eponymous New York
restaurant is one of 12 eateries outside France

JOEL ROBUCHON Openings this
year in New York, London, and
Hong Kong bring the overseas total
to nine

JACQUES & LAURENT POURCEL
Twin brothers from Provence have
six international outposts from
London to Shanghai

PIERRE GAGNAIRE Paris chef is eyeing expansion
in Asia after opening in Tokyo and London

GUY SAVOY First foreign restaurant will open soon
at Caesars Palace in Las Vegas



Towering tuna
at The Mansion

Data: BusinessWeek



INDIA

BLOOD, STEEL, AND EMPIRE-BUILDING

The father-and-son team at Mittal is in the hot lights after a bid for Euro-rival Arcelor

BY STANLEY REED

THE BATTLE FOR SUPREMACY in the global steel industry is getting personal. At a Jan. 30 press conference in Paris, Guy Dollé, chief executive of Arcelor, the world's second-largest steel producer, kicked off his defense against a brazen \$23 billion takeover bid from London-based Mittal Steel Co. with a dig at the predator's owner and boss, Lakshmi N. Mittal. After introducing three senior management colleagues, Dollé quipped: "My son is not on the management board."

Arcelor's chief was making a not-so-subtle reference to the fact that the Mittal clan exercises tight control over the steel giant and that the CEO's son, 30-year-old Aditya, serves in the key posts of president and chief financial officer. "If Lakshmi Mittal retired or got hit by a bus and Aditya took over, you wouldn't feel very good," says an industry source. He adds that while Aditya, who holds an undergraduate degree from Wharton, is sharp, it's the father who "has the strategic vision."

What's more, some worry that Mittal's board lacks independence, which the Mittals dispute. That—and the fact that only 12% or so of Mittal's shares trade freely—explains why the stock has typically traded at a discount of about 45% to its peers.

Mittal's cozy business ways are coming under scrutiny now that the Indian-born steel baron wants to weld a European giant onto his empire. No question looms larger than Aditya's place in a combined Mittal-Arcelor behemoth. "It is going to be an interesting question whether Aditya would survive in the enlarged group," says a source, noting that the son lacks the usual qualifications for serving as CFO, such as an MBA.

Still, Aditya is not just another spoiled rich kid. He has been a key player at his father's company since joining in 1997.

DYNAMIC DUO

Aditya and Lakshmi Mittal

He orchestrated the initial public offering that year and has worked on many acquisitions, including the \$4.5 billion purchase of International Steel Group Inc. from American investor Wilbur Ross in 2004. That deal transformed Mittal into the world's largest steelmaker and boosted the family's fortune to some \$20 billion. "Aditya has added a lot of value to the company and brought new perspective in terms of growth and strategy," says Lakshmi.

PRICING POWER

FATHER AND SON appear to complement each other well. Lakshmi, 55, has the entrepreneurial flair and the deep, hands-on knowledge of steel. Aditya is the number cruncher who's more comfortable with bankers and investors. "It's a very impressive double act," says someone familiar with the Arcelor deal. "Aditya is a very capable young man. His father listens to what he has to say."

Aditya says they hit on the idea of acquiring their Luxembourg-based competitor in November, after Mittal outbid Arcelor in a tough contest for Ukrainian Kryvorizhstal steel complex. Acquiring Arcelor would give Mittal greater pricing power and eliminate a rival in future deals. Mittal-Arcelor would have about 11% of the world market and sales of \$60 billion.

The markets see the logic in the deal. Shares in the two companies have soared since the bid was announced. Investors also hope that an Arcelor takeover will force the Mittals to address their corporate governance concerns. The Mittals are vowing to make the companies more independent of the family.

Directors to the six companies already claim. Aditya also hints he may have to cede his post to a more seasoned pro: "Perhaps I would not be in the way." The move would also boost Mittal shares available for trading, by paying back the clan's stake to 50.7%.

But the Mittals won't cede ground on one issue: "We don't see any reason to give up family control," says Lakshmi.

"In our view, family-controlled companies create better shareholder value. Looks like this dynamic duo isn't about to relinquish its super powers. ■"

MITTAL STEEL'S SURGE

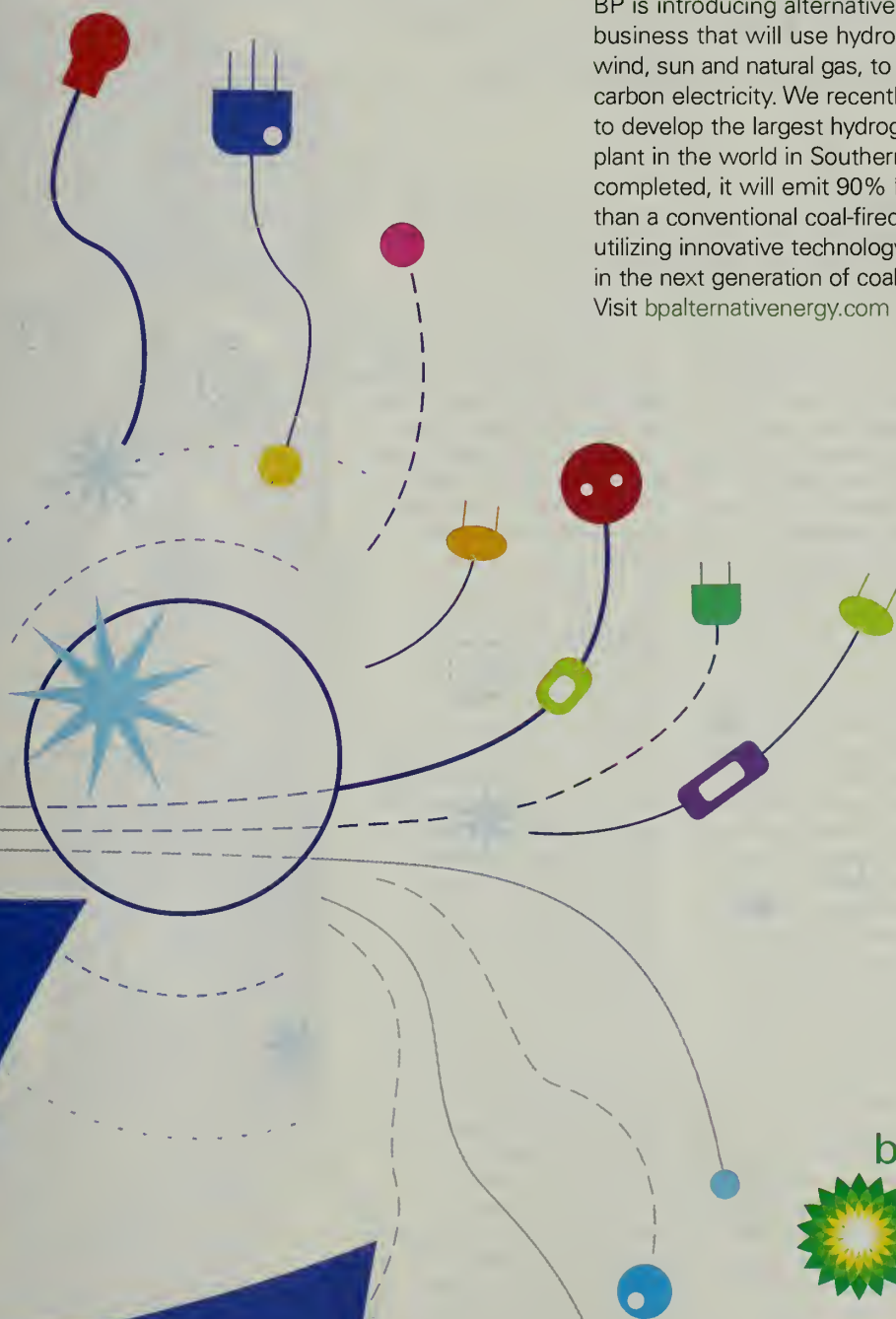
Investors are cheering the company's bid for its top rival



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BP is introducing alternative energy—a new business that will use hydrogen, as well as wind, sun and natural gas, to provide cleaner, low carbon electricity. We recently announced plans to develop the largest hydrogen-fueled power plant in the world in Southern California. When completed, it will emit 90% less carbon dioxide than a conventional coal-fired power station, utilizing innovative technology that can be used in the next generation of coal-powered facilities. Visit bpalternativenergy.com



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Giving the Boss The Big Picture

A “dashboard” pulls up everything the CEO needs to run the show

BY SPENCER E. ANTE

IT WAS NEW YEAR'S EVE, 2003, and Oracle Corp. CEO Lawrence J. Ellison was on his honeymoon. He and his bride, romance novelist Melanie Craft, were relaxing on his 243-foot Katana yacht off St. Barts, the Caribbean island known as a haven for movie moguls and rock stars. But Ellison, for the umpteenth time, couldn't help himself. He climbed to his office on the upper deck of the Katana, fired up his computer, and logged on to the Web site of a small company called NetSuite Inc. It was the last day of the fiscal year, and Ellison, the co-founder of NetSuite and its largest investor, needed to know if the startup was going to meet its numbers.

Before the Internet, Ellison says, taking the pulse of a company was sort of ridiculous. To get the latest sales information, he would call several people and wait days for them to process financial reports that often were out of date by the time he got them. "You would use your cell phone and work on feelings," he says.

But thanks to a new Web-based management tool known as a dashboard, Ellison had the information he needed in seconds. Like the instrument panel in a car, the computer version displays critical info in easy-to-read graphics, assembled from data pulled in real time from corporate software programs. Logging on to his dashboard for NetSuite, Ellison reviewed the financial data and saw surprisingly strong sales. He quickly called NetSuite CEO Zachary A. Nelson. Recalls Nelson: "The first thing he screams is: 'Are the numbers on my dashboard right?'" Nelson looked at his own dashboard, but his sales data were lower. So he pushed a refresh button. "The information came up with the new orders, and it was the exact

same number," says Nelson. "It was a very big high-five call."

Since the advent of the mainframe in the 1950s, companies have dreamed of using computers to manage their businesses. But early efforts came up short, with technology that was too costly or too clunky. Now, thanks to the Net and dashboards, those dreams are starting to come true. Forrester Research Inc. analyst Keith Gile estimates that 40% of the 2,000 largest companies use the technology. Some of the most prominent chief executives in the world are believers, from Steven A. Ballmer at Microsoft and Ivan G. Seidenberg at Verizon Communications to Robert L. Nardelli at Home Depot. "The dashboard puts me and more and more of our executives in real-time touch with the business," says Seidenberg. "The more eyes that see the results we're obtaining every day, the higher the quality of the decisions we can make."

The dashboard is the CEO's killer app, making the gritty details of a business that are often buried deep within a large organization accessible at a glance to senior exec-



How to Score Points with a Dashboard

A dashboard is software that's used to present corporate information, such as sales data and customer service requests, on a PC in colorful graphics, just like the speedometer of a car. Here are a few tips for making your dashboard a success:

1. START SLOWLY

Do not ram a dashboard down employees' throats. It can be seen as a tool that threatens their privacy or autonomy. In the beginning, it's wise to highlight organizational performance instead of individual performance.

2. PICK THE RIGHT INFO

A dashboard is only as useful as the data behind it. That's why it's crucial to invest time up front identifying the most important metrics. Without the critical info, the system won't be used.

3. BUSINESS SHOULD DRIVE

Some corporations allow their tech team to oversee a dashboard project. This is a no-no. Managers and employees should guide the development, in conjunction with the techies.

4. AVOID DATA OVERKILL

Displaying too much data may overwhelm and lead to micromanagement. Pick the six or seven most important metrics to show.

5. KEEP A PERSONAL TOUCH

Dashboards can be powerful tools to run your business, but don't spend all your time staring at the computer screen. Walking around and talking to workers will be at least as important.

es. So powerful are the programs that y're beginning to change the nature of management, from an intuitive art into re of a science. Managers can see key nges in their businesses almost int- naneously—when salespeople falter uality slides—and take quick, correc- action. At Verizon, Seidenberg and er executives can choose from among 0 metrics to put on their daslboards, n broadband sales to wireless sub- ber defections. At General Electric , James P. Campbell, chief of the Con- ner & Industrial division, which kes appliances and lighting products, ks the number of orders coming in n each customer every day and comes es that with targets. "I look at the dig- dashboard the first thing in the morning so I have a quick global view of sales and service levels across the organization," says Campbell. "It's a key operational tool in our business."



The technology is particularly valuable to small companies, since most of them couldn't afford sophisticated software in the past. Up until about five years ago, dashboards had to be custom built, so the expense could run into the millions of dollars. Now, NetSuite and others offer products that run \$1,000 to \$2,000 a year per user. "NetSuite brought on a total change in the way the company works and thinks," says Nate Porter, vice-president of American Reporting Co., a Kirkland (Wash.) provider of credit reports and other mortgage services.

PRIVACY CONCERNS

STILL, DASHBOARDS have drawn some flak. Critics say CEOs can miss the big picture if they're glued to their computer screens. GE agrees with that point. While business unit chiefs such as Campbell are active dashboard users, CEO Jeffrey Immelt is not, since he focuses on issues such as broad strategy and dealmaking that the technology can't yet capture.

Other critics fear dashboards are an alluring but destructive force, the latest incarnation of Big Brother. The concern is that companies will use the technology to invade the privacy of workers and wield it as a whip to keep them in line. Even managers who use dashboards admit the tools can raise pressure on employees, create divisions

in the office, and lead workers to hoard information.

One common concern is that dashboards can hurt morale. Consider the case of Little Earth Productions Inc., a Pittsburgh clothing manufacturer. The company uses NetSuite's tools to monitor the amount of business each salesperson has brought in and then displays it publicly. "You do feel bummed out sometimes if you are low on the list," says Ronisue Koller, a Little Earth salesperson.

Those pressures can lead to even bigger disruptions. NetSuite CEO Nelson says his dashboard allows him to read every e-mail sent by the sales staff and to inspect the leads of each salesperson. "It's frightening," he says. And it can have serious consequences. Once a month, Nelson plays "lead fairy" and looks at what sales leads have been followed up on and which ones haven't. One salesman quit when Nelson wrested away his sales leads that were not being used and gave them to others who were out of leads. "This raised enormous hackles in the company," says Nelson. "That's fine with me because he wasn't doing his job anyway."

Still, most management experts think the rewards are well worth the risks. They caution that executives should roll out the systems slowly and avoid highlighting individual performance, at least at first. They also underscore the need for business lead-

Now the CEO can read every e-mail sent by the sales staff

ers to spend time up-front figuring out which metrics are the most useful to track. But that's a question of how to use the technology, not whether to implement it. "You can't manage something you can't measure," says Ken Rau, managing partner at Bay Area Consulting Group LLC in San Francisco. "Dashboards are one of management's key techniques to make sure an organization is performing according to its objectives."

The intellectual foundation for dashboards was laid down in the late 1970s with the academic field of decision support systems. DSS introduced the idea that computer systems could be used to aid the process of decision-making. But it wasn't until the late 1990s, as the Internet linked up computers around the world, that companies began building the dashboards of today. In 1998, GE was one of the first companies to cobble together its own proprietary technology. The trend picked up steam after the recession of 2001, when efficiency became a priority. In the past few years, a new wave of software makers—including NetSuite, Salesforce.com, and Hyperion Solutions—have begun making dashboards that are even cheaper and easier to use.

A MUST-HAVE

NETSUITE, BASED IN San Mateo, Calif., was founded in 1998 by Ellison and Evan Goldberg, a former top software engineer at Oracle. In 2002, Nelson took over the company after leaving Network Associates. Today the company offers everything from dashboards to marketing software to tools for setting up an e-commerce Web site. NetSuite claims more than 7,000 customers, most of them small and midsize businesses. In 2005, it was the second-fastest-growing technology company in North America based on five-year sales growth, according to consultant Deloitte. And last year it was on track to hit \$70 million in sales, up from \$41 million in 2004.

One big fan of dashboards is Microsoft Corp., which of course makes plenty of business software itself. Jeff Raikes, president of the Microsoft division that makes its Microsoft Office software, says that more than half of its employees use dashboards, including Ballmer and

What's On Your Dashboard?



Steve Ballmer
MICROSOFT

Ballmer requires his top officers to bring their dashboards with them into one-on-one meetings. Ballmer zeroes in on such metrics as sales, customer satisfaction, and status of key products under development.



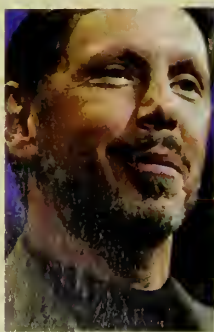
Ivan Seidenberg
VERIZON

Seidenberg and others can choose from more than 300 metrics to put on their dashboards, from broadband sales to wireless defections. Managers pick the metrics they want to track, and the dashboard flips the pages 24 hours a day.



Jeff Immelt
GENERAL ELECTRIC

Many GE executives use dashboards to run their day-to-day operations, monitoring profits per product line and fill rates for orders. Immelt occasionally looks at a dashboard. But he relies on his managers to run the businesses so he can focus on the big picture.



Larry Ellison
ORACLE

A fan of dashboards, Ellison uses them to track sales activity at the end of a quarter, the ratio of sales divided by customer service requests, and the number of hours that technicians spend on the phone solving customer problems.

chief software architect William I. Gates III. "Every time I go to see Steve Ballmer, it's an expectation that I bring my dashboard with me," says Raikes. Ballmer, he says, reviews the dashboards of his seven business heads during one-on-one meetings, zeroing in on such metrics as sales, customer satisfaction and the status of key products under development.

As for Gates, Raikes says the Microsoft founder uses a dashboard during his "think week," when he leaves the office and reads more than 100 papers about the tech industry prepared by employees. "He uses the dashboard to track what he has read and the feedback and actions that should be taken," says Raikes.

TROUBLESHOOTING

DASHBOARDS ARE a natural fit for monitoring operations. In manufacturing, GE execs use them to follow the production of everything from lightbulbs to dishwashers, making sure production lines are running smoothly. In the software business, Raikes uses his dashboard to track the progress of the upcoming version of Office. Shaygan Kheradmand, the chief information officer at Verizon, has on his dashboard what workers call the Wall of Shaygan: a replica of every single node on the telecom giant's network. All green is good. Yellow or red merits a closer look. Red means an outage somewhere. "It makes you move where you need to move," he says.

Dashboard technology can help keep customers happy, too. Before NetSuite, American Reporting Porter says customer-service reps just answered the phone and had no place to store client requests. Now the company's entire customer-service team uses the software. As a result, customer-service managers can see who is responding to calls. And service reps have access to every repair ticket, making it easier to handle customer problems. "It allows us to compete against some of the bigger boys," says Porter.

American Reporting isn't the only small fry that's benefiting. Joe Driggs, chief operating officer of Little Earth, took four months last year to move his business onto the NetSuite system. Little Earth sells futuristic eco-fashion products, such as a handbag made with recycled license

s. Today half of the company's 50 employees use the system to manage production, sales, and financial operations. "Once you see it is so intuitive, you wonder how we ran the business before," says Driggs.

In fact, Driggs ran the business by the feel of his pants, and it showed. Because the company had no system to measure production requirements or level of inventory materials, much of which came from China, it took about six weeks to make and ship a handbag. And Little Earth constantly struggled with cash problems because Driggs would often buy more trim pieces and twist-knob door handles than he needed. "You used to see dollars sitting on the shelves," he says. Now, using NetSuite, Driggs can monitor his purchase orders and inventory levels, and the system even alerts him when he is running low on closures from other parts. The result: Little Earth slashed its shipping time to three days. "All of those things that used to drive us crazy are literally at our fingertips," says Driggs.

It's near the end of a financial quarter. Oracle's Ellison tracks his customers like a hawk. "I want to know what our five biggest deals are three weeks before the quarter closes," he says. He looks at the [dashboard] several times a day. So much of our sales activity gets compressed into a few days." Ellison will then call the companies himself or assign another way to seal the deal. Since his honeymoon two years ago, Ellison has become more convinced that ever that dashboards are the way of the future. He just wishes more of his employees thought the way he does. The continuing frustration is that although all of Oracle's 20,000 salespeople use dashboards, Ellison says some 10% of them refuse to enter their sales data into the system. Salespeople don't want to be held accountable for a lead that isn't converted into a sale. That makes it hard to get a true picture of the demand for Oracle's products.

Ellison has considered refusing to pay commissions on a sale if the order is not entered into a dashboard, but for now he thinks such a move might prove to be a bit draconian. "The salespeople are the lifeblood of the independents," says Ellison. They think their Rolodex is private." Ellison, one of the world's richest men, concedes that technology—and the power it gives him—has its limits. People have to be persuaded that it's worth it," he says. ■

—With Jena McGregor in New York

Who Needs The Real World?

As enrollment dips, B-schools are taking more students without job experience

BY GEOFF GLOECKLER

LAST SPRING, AS HER FRIENDS celebrated on the eve of college graduation, Danielle Beyer was working on a 20-page paper due the next day. That's the downside of signing up for the University of Rochester's "3-2 MBA" program, allowing her to earn an undergraduate psychology degree in three years and an MBA from Rochester's William E. Simon Graduate School of Business Administration in two more. She has four months to go, but it has already paid off. In November, Beyer, 22, landed a job at National City Corp. with a pay package comparable to those offered to MBAs with years of experience. "I knew I would be coming out ahead," she says, "so I can't complain."

For a growing number of students like Beyer, the MBA race has turned from a marathon into a sprint. With the 2006 admission season well under way, many full-time programs—including Washington University, the University of Texas, Stanford, and Harvard—have begun to selectively drop the work experience requirement. That makes it easier for younger students to get through the door—boosting application numbers—and for women considering families to launch their business careers first. Janet T. Hanson, founder of 85 Broads, an advocacy group for women in business, says such policies may ultimately result in more women in the top ranks of business.

Says Hanson: "It's a proverbial win-win."

A hallmark of MBA education for nearly 20 years, the work experience requirement started as a way to move up in B-school rankings, which frequently reward programs with more experienced students, who typically fetch higher salaries. Over the years it has become an integral part of the curriculum, with students learning as much from peers as from professors. So while accepting undergrads may bolster enrollment, it could also destroy the delicate pedagogical balance that makes many MBA programs work—and send older students fleeing.

That's a risk some schools are willing to take. At Rochester, students with no work history account for nearly 20% of enrollment, and Dean Mark Zupan says that number could eventually reach 50%. The influx of young students has resulted in some "tensions," he concedes, but they are outperforming older students and receiving similar

BEYER
Getting her MBA at age 22



job offers. What's more, Rochester's relaxed policy on work experience allows the B-school to lure high-potential students who might be unreachable in five years. By then, Zupan says, many might be unwilling to forgo a big salary for two years of classwork, or will opt for a Top 10 program, not a mid-tier school like his.

Will the trend toward younger MBAs catch on? The applicant shortage that prompted the move shows signs of abating. But if applications don't pick up serious steam, don't be surprised if more B-schools post a "no experience needed" sign on the door. ■

BusinessWeek online For contrasting points of view, see www.businessweek.com/bschools/index.html

A Flashy New Adobe

In merging with Macromedia, the aim was to import its DNA as well as its product

BY SARAH LACY

A YEAR AGO, STEPHEN A. Elop had just become CEO of Macromedia Inc. and was getting ready for one of the most pivotal—and clandestine—dinner dates of his life. He was apprehensive as he drove down Highway 101 from the gourmand paradise of San Francisco to a cheesy Italian restaurant in San Jose—one he says he'd never be caught dead in now. "It wasn't the Olive Garden, and no one was singing *Happy Birthday* at the next table, but we had to go someplace where we wouldn't be seen together," he says. His date? Adobe Systems Inc. CEO Bruce R. Chizen. Only a few months after they began

flirting, they were engaged to be merged, on Apr. 18, 2005. They tied the knot on Dec. 3 in a \$3.4 billion deal, one of the largest in the rapidly consolidating software landscape.

Even before meeting Chizen, Elop knew a merger made strategic sense. Both companies make the bulk of their money selling to creative professionals. Their software—in both cases widely used on personal computers worldwide—was complementary. In terms of products they were more like twins separated at birth than competitors, with Adobe, pioneer of the PDF, more rooted in documents and Macromedia in the fast-growing world of Web design and mobile content. And Chizen's record spoke for itself. Since taking Adobe's helm in 2000, he'd built a steady, professional profit-maker: Revenues have leaped some 70%, to \$2 billion, and the stock is up nearly 40%, landing Adobe at No. 28 on the *BusinessWeek*

50 list of top corporate performers.

Culturally, though, the companies were leagues apart. Macromedia's home is a slick, loft-like space in San Francisco. Adobe is based in two San Jose towers that some Macromedia staffers scoff

"look like a bank." Creativity was prized at Macromedia, but its frenetic pace led many late nights. Adobe execs had perhaps fewer moments of exhilaration than more dinners at home with their families.

"ENTREPRENEURIAL SPIRIT"

AFTER THE MERGER announcement, the watercooler chatter at Macromedia turned anxious. Many employees worried that their company's unique culture would be wiped out. "We used to make fun of [Adobe's competing product] Creative Live," recalls Erik Larson, director of product management for several Macromedia products. "We always said: 'If they don't get it.'" But early post-merger action has seen Chizen reward ex-Macromedia people with key positions—part of an effort to imbue the new company with some of Macromedia's spark. "One of the things we were looking for in Macromedia [was its] great entrepreneurial spirit," says Chizen. "We wanted to get some of that into Adobe."

From the start, Chizen worked hard to ease any fears Elop might have about the merger. At that Italian dinner in San Jose, he articulated why he wanted to lead Macromedia—and it wasn't just for Flash Player. In just six weeks since the merger's close, he's done more than anyone expected. Chizen not only kept Macromedia's digs—now called Adobe San Francisco—he took an office there himself, splitting his time between the sites. And roughly half of the 700 people who were laid off came from Adobe. It was stunning and reassuring to Macromedia folks were the executive appointments. Elop took over the entire worldwide sales organization. Macromedia's former chief software architect, Kevin Lynch, assumed a similar role at Adobe for the Reader and the Flash player. And Macromedia executives were named to head Adobe's divisions.



ADOBE
CEO
CHIZEN

Adobe vs. Macromedia

The cultures are a study in contrast

ADOBE	MACROMEDIA
SOFTWARE	
» Rooted in documents and images	» Web and mobile interactivity
CULTURE	
» Slow, corporate, but steady	» Entrepreneurial, nimble, but stressful
WORKSPACE	
» "Bank-like" San Jose office towers	» Hip, exposed-brick open space

Data: BusinessWeek

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Some watch.
Some wait.
Some pounce.



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fastest-growing units: Acrobat, enterprise software, and mobile applications.

Suddenly it was the Adobe rank and file who were nervous—Macromedia appeared to be taking over. “I think it was a shock to Adobe employees and upsetting to many of them, [but] I get paid to make sure Adobe does well in the future,” Chizen says. Even outsiders noticed the shift. Carl Bass, COO of Autodesk Inc., a design software company just north of San Francisco, says the incoming résumés he has seen have switched from worried Macromedia employees to worried Adobe people. “That was wholly unexpected,” he says. Making the changes more pronounced, several Adobe execs have left voluntarily since the deal closed, including Chief Financial Officer Murray J. Demo.

COOL NEW PRODUCT

CHIZEN HOPES TO SEE the tough choices bear fruit soon. On Jan. 31, Adobe unveiled to analysts a strategy called “the engagement platform”—marrying the Web language HTML, Adobe Reader, and Macromedia’s Flash Player. For instance, someone looking to book a flight online, could, on the same screen, chat with travel companions about flight options, eyeing a snapshot of everyone’s schedules on one calendar. They could print nicely formatted itineraries, using Acrobat, complete with a bar code, to scan at the airport or rental car counter. With a click they could even send travel information to their phones.

That’s just using existing technology. Already a team of Adobe and Macromedia developers have started an innovative project to create a new version of Reader. Instead of just letting people view documents or fill out forms, it will run media-rich interactive Web applications thanks to the combination of Reader and Flash. The goal will be to install it on a majority of computers, just like Reader and Flash Player.

It’s all about squeezing more revenue and profit out of the ubiquity of the two technologies. Plans are to build similar prevalence on phones and consumer devices. While deals have been announced with Nokia, Samsung, and LG, Adobe has also closed deals with all of the world’s six largest handset makers. This quarter 66 million phones will have Flash up 50% over last quarter. If Chizen has his way, the new Adobe will find itself smack in the middle of every sexy trend from Web 2.0 to mobile content. Not bad for a company once criticized for not getting the Web. ■

The Undoing Of a Done Deal?

GM retirees are in court, charging the UAW pact gouges them unfairly on health costs

BY AARON BERNSTEIN

WHEN GENERAL MOTORS Corp. finally persuaded the United Auto Workers to slash \$1 billion a year out of the company’s crushing employee health-care costs last October, many applauded. But Leroy H. McKnight wasn’t clapping. The Lansing (Mich.) retiree has enjoyed top-notch medical coverage from GM since 2000, when he called it quits after 31 years. The new deal will cost him and GM’s 520,000 other UAW retirees and their dependents hundreds of dollars a year in extra insurance premiums and co-pays if it takes effect in April as planned.

On the other hand, GM’s 110,000 active union workers will pay hardly any of that. Their sacrifice: Forgoing pay hikes of \$1 an hour, or roughly \$2,000 a year, that had been slated for later this year and next. For McKnight, that’s peanuts. “The cuts are almost entirely visited on retirees, because we didn’t get to vote on them,” he gripes.

TEST CASE

SO MCKNIGHT and several hundred other GM retirees have asked a Michigan court to force the UAW to renegotiate its deal with GM as well as a similar one with Ford Motor Co. If they manage to derail the hard-fought agreements, it would be another big setback for the two auto makers. The fight is also being watched closely by other unionized employers itching to rein in retiree health costs, including those in auto parts, steel, and airlines. Says Arthur B. Smith Jr., a partner at Ogletree, Deakins, Nash, Smoak & Stewart who represents such companies: “This is a big test case.”

The UAW and GM insist the accord is fair to retirees, but they’re aware that the

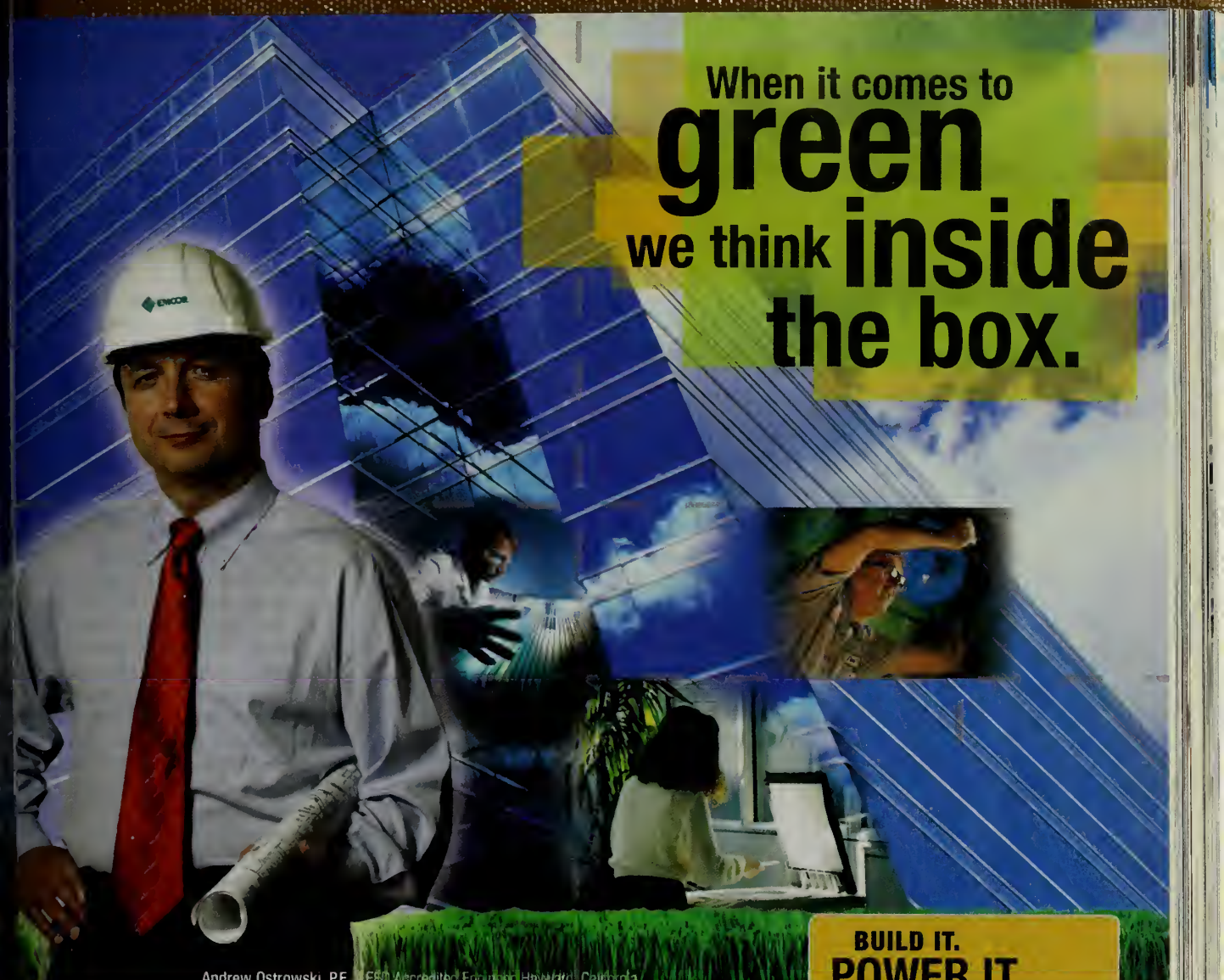
law is murky about changing negotia retiree benefits. To preempt such a challenge, the two sides agreed to an unusual tactic when they reached the pact last October. The UAW actually sued GM saying it had no right unilaterally to cut retirees’ coverage, as GM had threatened to do. Then the parties told the court they had settled the dispute with the UAW. “The union and the company both saw that there was some risk in each



MCKNIGHT
had no vote

legal position, so we agreed to seek court approval of the settlement,” says spokesman Stefan Weinmann. Michigan lawyer Mark S. Baumkel, who represents McKnight, argues that if GM can’t unilaterally cut vested benefits, then neither can the union.

Even if McKnight & Co. have a shot, their strategy could backfire. The judge in the case has set a “fairness” hearing for Mar. 6 to let all sides air their grievances. But reopening the pacts, which were passed by a 62% vote at GM and just at Ford, could give workers a chance to give thumbs-down to both in a referendum. Without some measure of relief, GM might have to consider the bankruptcy filing some Wall Street analysts recommend. And there’s one point all agree on: A bankrupt company is not within its rights to cut, or even abolish retiree benefits. ■



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Her unit, NOW
Broadband, has
more than 500,000
subscribers

This Is the Face Of Broadband TV

PCCW's Janice Lee has Net video thriving in Hong Kong—and she's not stopping there

BY BRUCE EINHORN

JANICE LEE LANDED HER first job out of college in the early 1990s with Star TV, a satellite network that was trying to beam programming across Asia. David Manion, her boss at the time, was quickly impressed and sent the 22-year-old off to India. The mission: build up Star TV's fledgling operation in the country. "I got all the senior executives telling me off for sending this little girl down the river," Manion says.

Lee more than held her own. With cricket-mad Indians gearing up for a test between the home team and England, she quickly figured out a way to make a splash. She set up a Star TV showroom in a Bombay storefront, with several TV screens facing the street. So many Indians gathered to watch Star's coverage that the police had to come and disperse the crowd. India went on to become one of Star's most important markets. "It was a roaring success," says Manion.

And an auspicious start for Lee, now 35. Since then, she has been in the thick of cutting-edge technology experiments in telecom and media. Four years ago she joined the Hong Kong telecom operator PCCW Ltd. to work with Chairman Richard Li, the second son of billionaire Li Ka-shing. As senior vice-president, she has helped bring PCCW's NOW Broadband into the league as a provider of television service using Internet technology anywhere. NOW Broadband boasts more than 500,000 subscribers, one-third of the total worldwide.

Lee has done it with a combination of marketing savvy and simplicity. The service, delivered over broadband phone lines, offers nearly 100 channels. Customers can pick channels one by one rather than buy broad packages, as with rival services. And she has been adding interactive features, giving viewers a chance to vote in polls or reserve movie tickets via TV. The goal is to keep them from losing interest in the staid old tube. "Young people are moving to the Internet, and we have to respond," she says.

That has put Lee and PCCW at the forefront of what promises to be a revolution in TV. The technology they're using is known as IPTV, for Internet Protocol television. It's a technology that telecom operators worldwide are bracing as they try to diversify beyond their declining voice businesses into television. In the U.S., both Verizon Communications Inc. and AT&T plan to begin IPTV services this year. PCCW is using its technology expertise to pa-

other telecom companies and move new markets, beginning with mainland China. "We are lucky to have 100 channels coming up," says Li, "but we're not lucky that we only have 7 million people" living in Hong Kong. Her company may even begin selling its technology in competition with the likes of Microsoft Corp. and Siemens.

EXPERIENCE THAT IS UNIQUE"

Her SUCCESS IS ATTRACTING the attention of big-time investors. On Jan. 26, Newbridge Capital LLC, a private equity firm owned by San Francisco-based Newbridge Pacific Group, announced a bid to pay \$125 million for a 6% stake in PCCW, partly because of its Internet television business. PCCW's accomplishments so far with NOW Broadband are "really remarkable," says Timothy D. Dattels, managing director of Newbridge. "What they have done is definitely something they can't do in other markets. They have gained experience that is unique."

As a media pioneer, Lee didn't spend much time watching TV as a child. When she was growing up, the pampered middle child of a well-off dentist and his wife, Lee's Hong Kong had just two networks, each offering one channel in English and one in Cantonese. She remembers watching locally made Chinese serials, with an occasional program such as *Charlie's Angels* or *Hilligan's Island* thrown in.

She learned independence early on. Her parents sent her and her two siblings off to live in suburban Sydney as teenagers, a common way for Hong Kong residents to acquire foreign passports following the 1985 agreement between Beijing and London to return the Crown Colony to Chinese rule. Lee's father stayed behind in Hong Kong, and her mother was often there, too. "In Hong Kong, people guide you along," her brother Eric remembers. "All of a sudden, we were in this big house." It took a while to adjust. At one point, their front lawn was so overgrown that some neighbors came and mowed the lawn themselves. But soon the three children got used to shopping for groceries, preparing dinner, and washing the car without adult supervision.

As much as she grew to enjoy the relaxed Aussie lifestyle, she missed what she called the "vibe and the buzz" of Hong Kong. So after graduating from the University of Sydney with a degree in economics, commercial law, and accounting, she returned home. "It didn't even cross my mind, not coming back to Hong Kong," says Lee. Wanting stability and security for his daughter, her father expected

Lee to become an accountant—and even used some connections to arrange a job for her. But Lee opted for a job in television instead. "He wanted her to be a professional," says Pauline Chu, a childhood friend of Lee's and godmother of her 4-year-old daughter. "But she was very outgoing and ambitious. I never thought she would be a bean counter."

Still, Lee learned a lot from her father. The dentist showered special attention on his patients to keep them coming back, including giving away umbrellas during the rainy season. Lee also credits her years in Australia with helping her communicate across cultures, something that

ping, horse-racing highlights, and hundreds of movies available on demand.

Impressive, sure. But consumers found iTV and all its choices too confusing. In 2000, shortly after PCCW acquired Hong Kong Telecom, Li closed it. "It was wonderful technology, very ahead of its time," says Lee, who after iTV's closure left for a job at Citigroup. "But we were asking too much of consumers."

She says she has learned her lesson from the iTV days. More than two years after NOW Broadband's launch, Lee is just starting to market video on demand, and with limited choices to begin with. "This time around, we want to train

BIO

Janice Lee

She learned business basics from Dad, a Hong Kong dentist with an entrepreneurial streak

BORN June 17, 1970.

FAMILY Married with a 4-year-old daughter, Liberty. Her husband, Lee Chapman, runs his own publishing business, specializing in Chinese-language children's stories.

EDUCATION Attended high school at Presbyterian Ladies' College, an all-girls school in New South Wales, Australia. Later earned a bachelor's degree at the University of Sydney.

FORMATIVE EXPERIENCE Lee (pictured, right) and her two siblings lived in Australia during the 1980s, largely on their own. At one point, the kids' lawn became so overgrown that the neighbors came over to mow it. Still, Lee quickly learned how to look after herself.

MAJOR RESPONSIBILITIES Lee is building



LEE (right), with her brother

NOW Broadband, the pay-TV service from Hong Kong telecom operator PCCW. With 500,000 subscribers, it's the leading provider of Internet television service in the world.

MAJOR INFLUENCE Her father. He was a dentist who understood how to be "very entrepreneurial," she says. Beyond providing good service, he kept patients coming back by offering such freebies as toys and umbrellas.

has come in handy as she deals with Western programming partners.

One big reason for the success of NOW to date has been the exclusive deals that Lee has negotiated with U.S. companies. In the past, media giants like Walt Disney Co. wouldn't allow their shows to be distributed in Hong Kong for fear of piracy. Lee helped convince many that IPTV's security was strong enough that there would be no breaches. The result: PCCW is the only company in Hong Kong that carries ESPN, HBO, and the Disney Channel.

Lee is moving slowly with interactive features, though. That's because her success with NOW Broadband comes after several failures. In the late 1990s, after Star, Lee headed marketing at iTV, a first-of-its-kind service owned by Hong Kong Telecom. The service offered home shop-

ping, horse-racing highlights, and hundreds of movies available on demand.

ping, horse-racing highlights, and hundreds of movies available on demand. "Give them enough to chew on, but not too much." PCCW debuted some on-demand adult programming in the fall and is now expanding that to include regular Chinese-language movies. "We're not even branding it as video on demand," says Lee, who instead is calling the service NOW Select. The goal is to get people accustomed not just to watching TV but also to interacting with it. "It's all about training them to use the remote quite differently," she says, pointing to the yellow, red, blue, and green buttons on the NOW remote control. "All they need to know is the four color buttons and the 'enter' button." For now, this ease of use is available only from Lee and PCCW. But it may point the way to the future of television. ■



Is Verizon a Network Hog?

It wants to devote most of its capacity to its own traffic, to Net companies' dismay

BY CATHERINE YANG

LAST NOVEMBER, VINTON G. Cerf wrote a letter of warning to Congress. The legendary computer scientist, now a vice-president at Google Inc., argued that major telecom companies could take actions to jeopardize the future of the Internet. The phone companies' networks that carry Net traffic around the U.S. are much like the highway system. Cerf wrote that they may begin setting up the equivalent of toll booths and express lanes, potentially discriminating against the traffic of other companies. Such moves, Cerf warned, "would do great damage to the Internet as we know it."

Now, Cerf and his Net compatriots have new ammunition to back up their fears. Documents filed with the Federal Communications Commission show that Verizon Communications Inc. is setting aside a wide lane on its fiber-optic network for delivering its own television

service. According to Marvin Sirbu, an engineering professor at Carnegie Mellon University who examined the documents, more than 80% of Verizon's current capacity is earmarked for carrying its service, while all other traffic jostles in the remainder.

Leading Net companies say that Verizon's actions could keep some rivals off the road. As consumers try to search Google, buy books on Amazon.com, or watch videos on Yahoo!, they'll all be trying to squeeze into the leftover lanes on Verizon's network. On Feb. 7 the Net companies plan to take their complaints about Verizon's plans to the Senate during a hearing on telecom reform. "The Bells have designed a broadband system that

squeezes out the public Internet in favor of services or content they want to provide," says Paul Misener, vice-president for global policy at Amazon.com Inc.

Verizon argues that it needs to take such measures to earn a return on its network work investments. The New York giant, seeing steep declines in its traditional telephone market, so it is spending an estimated \$10 billion over seven years on fiber lines to diversify into the TV business. Unless it can deliver seamless, high-quality TV service—a real bandwidth hog—Verizon says it won't be able to compete against Comcast Corp. and other cable providers. We "give consumers choice for video services," says Verizon Executive Vice President Thomas J. Tauke.

PAYING FOR PRIORITY

AT ISSUE IS WHAT the Internet of the future will offer. Critics of the phone industry say the Net has flourished because innovators anywhere could reach consumers just as easily as deep-pocketed corporations. But if Verizon and AT&T set up tolls and express lanes, upstarts may not be able to afford the fees. "If you deliver video the way Verizon does now, it makes it very hard for others to compete," says Carnegie Mellon's Sirbu.

The Net companies are trying to persuade Congress to pass a law ensuring that broadband providers, such as the Bells, don't discriminate against rivals when they charge tolls or prioritize traffic, an idea called "network neutrality."

Verizon says there's plenty of room in its network for everyone. Still, the growing controversy is giving the company second thoughts about its legislative strategy. Last year it was pushing Congress for comprehensive telecom reform. But now Verizon is paring its ambitions. At a Jan. 27 press conference, Verizon's Tauke said it was timing lawmakers to switch gears and

move off piecemeal issues. On the list is a bill on franchise approvals that would allow phone companies to offer TV service across the country more quickly.

Meanwhile, net neutrality faces more debate in the Senate and the House. Cerf & Co. certainly has a difficult task. After all, phone companies employ armies of lobbyists and have won millions to Congress. Google hired its first lobbyist just last year. ■

THE STAT

80%

The percentage of Verizon's network capacity that might be used for carrying its own video service.

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EDITED BY
ADAM ASTON

INNOVATIONS

Of fetal testing and libido boosters

» Scientists at **Xenomix** have discovered a way to detect possible genetic diseases in a fetus by screening the mother's urine. In some chromosomal disorders, such as Gaucher's disease and Down syndrome, key pieces of fetal DNA pass through the mom's kidneys. The company is developing tests that can detect disease telltales at seven weeks, six sooner than today's more invasive procedures, and can also reveal the gender.

» In the *British Journal of Ophthalmology*, researchers at the **University of Alabama at Birmingham** reaffirmed the link between vision problems and erectile dysfunction drugs. They studied men who had histories of heart trouble, and

found that those who had taken Viagra or Cialis were 10 times as likely to have optic nerve damage as those who had not.

» For women,

meanwhile, caffeine may offer a natural boost to the libido. Scientists at **Southwestern University** in Georgetown, Tex., found that female rats were more interested in sex after a dose of caffeine, according to *Pharmacology Biochemistry and Behavior*. In the test, females returned for second encounters with males more quickly if they had received a moderate amount of the stimulant. The researchers are planning further studies to assess the effects of repeated exposure to caffeine.

—Michael Arndt



ROBOTICS

MIMICKING THE MARCH OF THE PENGUINS

PENGUINS ARE MORE than just the cuddly stars of wintertime ads and documentaries. The tuxedoed birds may help unlock the mysteries of two-legged motion and could help robots learn to balance better.

Thanks to an innate ability to adjust for their squat build, penguins can waddle for miles without toppling over. The key is a side-to-side rocking motion that carries them forward efficiently, if inelegantly. Such movements are tricky for humans because our brains do a bad

job adjusting for drastic sideways motions.

Now, the University of Houston's Max Kurz hopes to adapt the birds' unique gait to robots. The professor of health and human performance tracks the width and length of the penguins' steps as they traverse a pressure-sensitive mat. The data could improve the march of future bots by replacing cumbersome motion-control equipment with computers that guide more natural forward motion. —Arlene Weintraub

DIAGNOSTICS

A CHIP THAT CAN DETECT AVIAN FLU

A SWIFT, LOW-COST test for avian flu could help cut the risk of a deadly pandemic. Switzerland's **STMicroelectronics** has married biology and chip technology to roll out one of the first "lab-on-chip" flu tests. In under an hour, claims the company, the chip can ID the most lethal variety of avian flu, H5N1, plus over 20 more common influenza strains.

The secret to STMicro's semiconductor is snippets of synthetic DNA that closely

mirror the DNA in H5N1 and other flu types. Prepared by Veredus Laboratories in Singapore, the synthetic DNA binds to its natural counterpart when exposed to an infected blood sample. In the case of a match, the chip emits a tiny burst of energy, which an optical sensor detects.

The kit works with both human and avian samples. And at less than \$10,000, says Anton Hofmeister, general manager of STMicro's microfluidic division, the kit will cost about a tenth of a comparable laboratory setup. Veredus, which will be distributing the testing kits, aims to get them to market by autumn, just in time for the next flu season.

TELECOM

OPTICAL LASERS: TRUNK LINES IN SPACE?

LONG AGO, fiber-optic cable carrying light pulses replaced satellites as the main conduit for the tide of data, voice, and video surging around the globe. That's because even though satellite-bound radio signals travel as fast as laser pulses, clever processing can pack more data into light waves.

Now scientists are turning to lasers to make planet-to-planet connections. Last spring, NASA researchers sent a tightly focused light beam some 15 million miles to a 1-inch-wide sensor on the *Messenger* space probe, then just beginning its seven-year meander to Mercury. The craft blinked back via a laser that, at 30 watts, is no more powerful than an oven burner.

The linkup marked the use of optical lasers for two-way communication at such distances, says David Smith, NASA astronomer. The results, published in *Science*, suggest that interplanetary laser relays could work up to 1,000 times faster than today's radio links. That's plenty fast for video. Next *Survivor: Mars?*



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Why The Economy Is a Lot Stronger Than You Think

In a knowledge-based world, the
traditional measures don't tell the story

BY MICHAEL MANDEL

YOU READ THIS MAGAZINE RELIGIOUSLY, WATCH CNBC WHILE DRESSING FOR WORK, scan the Web for economic reports. You've heard, over and over, about the underlying problems with the U.S. economy—the paltry investment rate, the yawning current account deficit, the pathetic amount Americans salt away. And you know what the experts are saying: that the U.S. faces a perilous economic future unless we cut back on spending and change our profligate ways.

But what if we told you that the doomsayers, while not definitively wrong, aren't seeing the whole picture? What if we told you that businesses are investing about \$1 trillion a year more than the official numbers show? Or that the savings rate, far from being negative, is actually positive? Or, for that matter, that our deficit with the rest of the world is much smaller than advertised, and that gross domestic product may be growing faster than the latest gloomy numbers show? You'd be pretty surprised, wouldn't you?

Well, don't be. Because the economy you thought you knew—the one all those government statistics purport to measure and make rational and understandable—actually may be on a stronger footing than you think. Then again, it could be much more volatile than before, with bigger booms and deeper busts. If true, that has major implications for policymakers—not least Ben Bernanke, who on Feb. 1 succeeded Alan Greenspan as chairman of the Federal Reserve.

Everyone knows the U.S. is well down the road to becoming a knowledge economy, one driven by ideas and innovation. What you may not realize is that the government's decades-old system of number collection and crunching captures investments in equipment, buildings, and software, but for the most part misses the growing portion of GDP that is generating the cool, game-changing ideas. “As we've become a more knowledge-

based economy," says University of Maryland economist Charles R. Hulten, "our statistics have not shifted to capture the effects."

The statistical wizards at the Bureau of Economic Analysis in Washington can whip up a spreadsheet showing how much the railroads spend on furniture (\$39 million in 2004, to be exact). But they have no way of tracking the billions of dollars companies spend each year on innovation and product design, brand-building, employee training, or any of the other intangible investments required to compete in today's global economy. That means that the resources put into creating such world-beating innovations as the anticancer drug Avastin, inhaled insulin, Starbucks, exchange-traded funds, and yes, even the iPod, don't show up in the official numbers.

Now, a generation of economists who came of professional age watching the dot-com boom and bust are trying to get a grip on this shadow economy: People like Carol A. Corrado and Daniel E. Sichel of the Federal Reserve Board, who, along with Hulten, figured out that businesses are spending much more on future-oriented investments than widely believed. In a way, these economists are disciples of Greenspan, who understood earlier than most that the conventional numbers don't capture the emerging knowledge economy.

Greenspan was continually digging into arcane factoids he hoped would give him a better insight into what was going on under the hood of the U.S. economy. And Bernanke seems to understand the importance of doing the same. In a speech last year, he said that intangible investments "appear to be quantitatively important." As a result, Bernanke noted, "aggregate saving and investment may be significantly understated in the U.S. official statistics."

BEYOND WIDGETS

AS GREENSPAN WOULD BE the first to tell you, it's a lot easier counting how many widgets the nation produces in a year than quantifying the creation and marketing of knowledge. After all, we're talking about intangibles: brand equity, the development of talent, the export of best practices.

This stuff is hard to measure, but to ignore it is to miss what the economy is telling us. And to miss that is to increase the likelihood of committing policy blunders. Including these intangible investments could provide a better picture of the economy, one that offers more advance warning of recessions, slippage in our ability to innovate, and other nasty surprises.

To understand why the government measures the economy the way it does, it helps to go back in time to the 1930s. The Great Depression had the nation in a death grip, and government planners and politicians lacked the tools to answer the big question of the day: Was the economy getting better or worse? To find out, the Commerce Dept. brought in economist Simon Kuznets, then at the National Bureau of Economic Research, to calculate for the first time the nation's income and output—the purchasing power and production of the U.S. economy. Setting such a benchmark would allow the government to figure out if the economy was growing or shrinking.

Working with handwritten data, Kuznets and a small group of

FEDERAL GOVERNMENT

Data: Office of Management and Budget, Congressional Budget Office



BUSINESS

Business investment in intangibles such as product development and training is critical for long-term profitability, but it doesn't get counted in GDP.

Unmeasured intangibles **\$978**

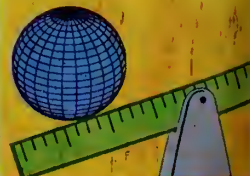
Physical capital and software **1139**

Billions of dollars, Average for 2000-2003
Data: Corrado, Hulten, Sichel

The Shadow Economy

Intangibles such as R&D, training, education, and creation of knowledge are poorly tracked by today's statistics. Here's how better counting of intangibles would change our picture of the economy:

THE REST OF THE WORLD



ent outlays for education and R&D are incorrectly
current consumption, rather than future-oriented
it.

on/research and development	\$215
capital	181
of rest of federal budget	78

estimates for fiscal year 2005

ment is rising as a
ne economy,
n falling.

rent account
considerably smaller.

sonal savings
05 was positive,
ve.

t of the federal
voted to current
s in balance.

01 recession was
an we thought.
rowth, however,
onger.



FAMILY

Household outlays for education, the most important investment in the future of the next generation, are improperly counted as consumption in the published data.

Education **\$224**

**Personal savings, as
officially measured** **-42**

Billions of dollars, 2005
Data: Bureau of Economic Analysis

trade statistics do not reflect the human capital
might into the country by skilled immigrants. The
numbers also do not show the flows of knowhow that
multinationals to reap high returns on their
operations.

ed inflows of human capital **\$50-\$200***
ed exports of knowhow **\$25-\$100***

ual average for 2000-2004

Data: BusinessWeek

fellow economists began counting tangible things like machines and buildings as long-term investments. It made sense, since this was still the Industrial Age. And such calculations came in handy during World War II, when the Roosevelt Administration needed a fix on the nation's capacity to grind out tanks, ships, and planes.

A BREAK WITH THE PAST

KUZNETS' WORK SET THE TONE for the rest of the century, not to mention helping win him the Nobel prize in Economics in 1971. Machines and buildings were counted as future-oriented investment, but spending on education, training, and R&D was not. No attempt was made to judge the social utility of expenditures. For example, the \$6 million cost of building the Flamingo Hotel, the Las Vegas casino opened by Bugsy Siegel in 1946, was tallied as an investment. But AT&T's funding of Bell Labs, where the transistor was invented around the same time, wasn't even included in GDP. Kuznets himself acknowledged the limitations of his system, yet it stayed basically the same for most of the postwar period.

By the early '90s, Greenspan was becoming increasingly frustrated by the official numbers' inability to explain a rapidly evolving economy. In 1996 and 1997 he refused to accept conventional data telling him that productivity growth was falling in much of the service sector, noting—correctly, as it turns out—that “this pattern is highly unlikely.” He also pointed out that the official numbers for consumer inflation were too high.

At the Washington offices of the BEA, J. Steven Landefeld, who became director in 1995, felt pressure to include numbers that better reflected the knowledge economy. Landefeld isn't a rash fellow, and the pace of change at the BEA, while quick for a statistical agency, would be called deliberate by most. But in 1999—six decades after Kuznets laid the groundwork for calculating GDP—Landefeld and the BEA decided to break with the past.

The BEA started treating business spending on software as a long-lived investment. The decision was overdue. Companies were spending more than \$150 billion annually on software, far more than the \$100 billion for computer hardware. And the software often stayed in use longer than the hardware. The fact that econo-

mists could go into stores and see software in brightly colored boxes reassured them that it was real. “Prepackaged software is a lot easier” to count, recalls Landefeld.

Silly as it may seem now, it was a revolutionary change at the time. But over the past seven years the economy has continued to evolve while the numbers we use to capture it have remained the same. Globalization, outsourcing, and the emphasis on innovation and creativity are forcing businesses to shift at a dramatic rate from tangible to intangible investments.

According to *BusinessWeek's* calculations, the top 10 biggest U.S. corporations that report their R&D outlays—a list that includes ExxonMobil, Procter & Gamble, General Electric, Microsoft, and Intel—have boosted R&D spending by 42%, or almost \$11 billion, since 2000. Yet over the same period, they have only increased capital spending by a meager 2%, or less

Unmasking the Economy

The Knowledge Economy and You: Advice for investors and workers

A GDP Primer: How the numbers are calculated

The Story Behind the Story: For a podcast interview with Chief Economist Michael Mandel by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

The Blog: To discuss intangibles with Mandel, go to businessweek.com/the_thread/economicsunbound/



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than \$1 billion. So all together, these giants have actually increased their future-oriented investment by roughly \$12 billion—most of which doesn't show up in the BEA numbers.

This shift to intangibles looks all the more remarkable when we look a bit further back. P&G, for example, has boosted its spending on R&D, which doesn't count as investment in the GDP statistics, by 39% since 1996. By contrast, the company's capital budget, which does factor into GDP, is no bigger today than it was back then. The same is true at spicemaker McCormick & Co., where capital spending is basically flat compared to 1996 but R&D outlays to create new products have tripled over the same period.

Want to see how this works? Grab your iPod, flip it over, and read the script at the bottom. It says: "Designed by Apple in California. Assembled in China." Where the gizmo is made is immaterial to its popularity. It is great design, technical innovation, and savvy marketing that have helped Apple Computer sell more than 40 million iPods. Yet the folks at the BEA don't count what Apple spends on R&D and brand development, which totaled at least \$800 million in 2005. Rather, they count each iPod twice: when it arrives from China, and when it sells. That, in effect, reduces Apple—one of the world's greatest innovators—to a reseller of imported goods.

That's why the new research from Corrado, Sichel, and Hulten is so important, and why building and improving upon it could become a key goal of economists in the coming years. Ultimately, we might end up with a "knowledge-adjusted" GDP, which would track the spending so crucial for global competitiveness.

Right now, though, rough calculations of these intangibles are all we have. To help come up with their \$1 trillion number for un-

measured business investment, for example, Corrado, Sichel, and Hulten counted the portion of advertising designed to have long-lived effects on perception (that would include the sort of corporate image advertising seen in this magazine). They also estimated the value of new product development in the financial-services industry, which current R&D numbers miss. "We had to hunt around for bits and pieces of data," says Hulten.

Assessing how much bang for the buck companies get from their spending on intangibles is even harder, especially in the fast-changing knowledge economy. Take employee training, the old days, that required flying people to a teaching facility which cost companies a lot of time on top of the cost of the instructors and real estate. Now online learning and other innovations are driving down the cost of training. At IBM, the training budget fell by \$10 million from 2003 to 2004, a 1% decline, while the number of classroom and e-learning hours rose by 29%. Are other companies seeing an equally dramatic decline in the cost of training? No one knows.

CHANGING PERCEPTIONS

THAT'S WHY THE BEA doesn't want to move too fast. It plans to publish supplementary accounts for R&D in the next few years, which will track R&D spending without adding it into the official GDP numbers. Other intangibles, though, remain below the radar. "No one disagrees with this conceptually," says BEA chief Landefeld. "The problem is in the empirical measurement."

But look at how our perception of the economy changes once you add in things like R&D and brand-building. The published data show that total investment—business, residential, and government—has been falling over the past three decades, while its share of national spending, while consumption has been rising.

The numbers say growth slow

Add in the intangible investments provided by our three economists, and the picture changes completely.

Total investment rises, going from 23.8% of national spending in the 1970s to 25.1% in the early 2000s—much higher than the 18.3% the conventional numbers show. That helps explain why the economy has sustained strong productivity growth, and why foreign investors continue to pour money into the U.S.

Factoring in the knowledge economy also helps us understand why the recession of 2001 seemed worse than the off-

I vehemently

I wholeheartedly

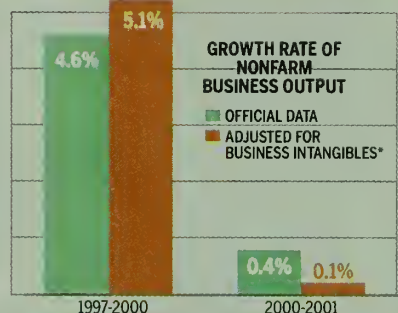
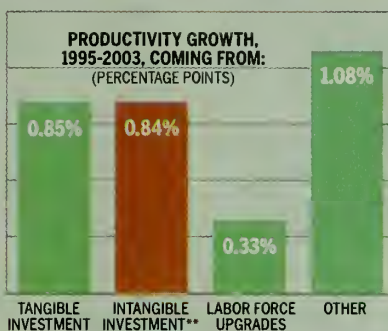
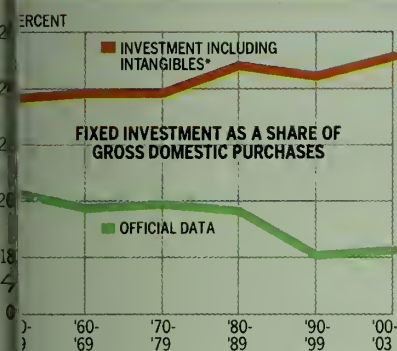
Factoring in the Missing Pieces

Including R&D, training, and other intangibles in the numbers helps explain a decade of economic reality

The growing importance of intangibles...

...helped drive the New Economy...

...but worsened the boom and bust



*INCLUDES SPENDING ON R&D, PRODUCT DEVELOPMENT IN FINANCE AND INFORMATION INDUSTRIES, THE CREATION OF LONG-LIVED BRAND EQUITY, EMPLOYEE TRAINING, AND ORGANIZATIONAL CHANGE AND DEVELOPMENT INCLUDING SOFTWARE

Source: Corrado, Hulten, and Sichel; Bureau of Economic Analysis; National Science Foundation; Universal McCann; BusinessWeek

...tics showed—and why the recovery was so slow. According to the published numbers, the six-month recession of 2001 was so mild the business sector actually grew at a modest 0.4% that year. By 2003, however, more than 3 million private jobs had disappeared.

The reason for this disconnect is simple: Corporations added back their budgets for R&D, advertising, training, and so on. Yes, that canceled out a ton of high-paying jobs, but had

business intangibles would have changed the growth numbers. For our purposes, let's assume that overall intangible business investment followed the same path as industrial R&D and advertising, for which annual data are available. Crunch the numbers and it looks like the business sector really grew by only 0.1% in 2001, less than a quarter of the size of the official increase. Growth in 2002 now also looks slower than the published data.

By contrast, the conventional numbers may be understating the strength of the economy today. The BEA announced on Jan. 27 that growth in the fourth quarter of 2005 was only 1.1%. In part that was because of a smaller-than-expected increase in business capital spending. However, employment at design and management-consulting firms is up sharply in the quarter, suggesting that businesses may be spending on intangibles instead. Indeed, the consumer confidence number for January zoomed to the highest level since 2002, as Americans became more optimistic about finding jobs.

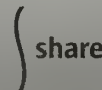
Then again, the economy may hit bigger bumps in the years ahead. When companies significantly trim their spending on R&D, design, training, and other knowledge-enhancing activities, as they did in 2001, the resulting pain in terms of job loss-

Jobs for designers jumped

...direct effect on GDP. Remember that R&D and other intangible business investments are not currently counted as national output. Therefore, when a company laid off an engineer doing long-term product development but kept selling the same number of its old products, GDP stayed the same. Productivity even went up, because fewer workers were producing the same amount of output. And if that laid-off engineer went to work building houses? National output might even have risen. There's enough data available through 2003 to estimate how

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Trade stats miss a big chunk of the value-creating flow of knowledge

ens and reduced innovation could deepen the next downturn.

Perhaps the trickiest and most controversial aspect of the shadow economy is how it alters our assessment of international trade. The same intangible investments not counted in GDP, such as business knowhow and brand equity, are for the most part left out of foreign trade stats, too. Also largely ignored is the mass influx of trained workers into the U.S. They represent an immense contribution of human capital to the economy that the U.S. gets free of charge, which can substantially balance out the trade deficit of goods and services. "I don't know that the trade deficit really tells you where you are in the global economy," says Gary L. Ellis, chief financial officer of Medtronic Inc., a world leader in medical devices such as implantable defibrillators. "We're exporting a lot of knowledge."

Time for another real-world example. In December, Intel Corp. announced plans to build a new wafer-fabrication plant in Israel. To the statisticians, the value of that foreign investment is the book value of the plant—that is, the cost of erecting the building and installing the chipmaking machinery.

Not counted is the systematic export of knowhow to Israel that enables that factory to operate profitably. At the core is a program called Copy Exactly!, which requires that a new fab duplicate an existing one that is working well, down to how often the plant's pumps are serviced. All of this critical information is documented and transferred from the U.S. to the new plant, but it is not picked up by the trade statistics.

The numbers don't catch Intel's exhaustive training program either. To get its new plants running quickly, the chipmaker brings 800 or 900 employees from the new fab to spend a minimum of six months in Hillsboro, Ore., where Intel develops new production processes. By the time they return home, these people will have picked up not just the details of the process but also tribal knowledge—the unwritten lore of how Intel works. With that info in their heads, they're equipped to get the new factory up and running at high volume within a quarter, rather than taking a year or more. In economics speak, this is a classic transfer of human capital. So why isn't it called an export?

Ricardo Hausmann, director of

Harvard's Center for International Development, believe should be. He describes these cross-border flows of knowhow "dark matter." Hausmann notes that U.S. multinationals consistently earn higher rates of return than their foreign counterparts—an average of 6% on foreign operations since 2000, vs. 1.2% foreign multinationals earn in the U.S., according to the latest BEA figures. From that, he infers that the multinationals benefiting, in part, from knowledge exported from the U.S. country with faster productivity growth than the rest of the industrialized world.

Using these arguments, Hausmann finds that the U.S. current account deficit actually disappears, averaged over time. "With globalization, you develop a blueprint and sell it in all countries," says. "Countries that are good at creating blueprints get more exports of dark matter."

Admittedly, most trade experts are hostile to Hausmann's conclusions. A recent report from Goldman, Sachs & Co. likened Hausmann's dark matter to cold fusion. And the economists at the BEA worry that adding knowledge exports to the trade stats would make published data less useful. "I have a problem putting fabricated figures into exports," says Ralph H. Zlotow, who oversees international accounts at the BEA. "You get into an impossible statistical maze when you try to value all of this at something that anyone would believe."

But even if Hausmann is overstating his case, he's on the right track. There's no doubt that the statistical problems are formidable but it's also certain that the conventional trade statistics are missing a big portion of the knowledge flows that create value these days. Suppose we assume that multinationals can earn an average percentage point of return on foreign investments by being able to use business intangibles exported from the U.S. Then a rough estimate of the value of the uninsured exports of knowledge is anywhere from \$25 billion to \$100 billion per year, depending on what assumptions are used.

And let's not forget about immigrants. The workers who move to the U.S. each year bring with them a mother lode of educational skills—human capital—for

Big Companies Go Intangible

Companies are putting more emphasis on R&D and less on capital investment. Since 2000, the "intangibility index"—the ratio of R&D to capital spending, multiplied by 100—has risen for 9 of the 10 biggest U.S. companies that report R&D

COMPANY	INTANGIBILITY INDEX* 2000	LATEST**
EXXONMOBIL	5.1	4.4
GE***	73.6	100.7
MICROSOFT	429.1	761.6
PROCTER & GAMBLE	62.9	89.0
PFIZER	211.0	295.4
JOHNSON & JOHNSON	183.8	239.2
ALTRIA	32.0	42.3
CHEVRONTXACO	2.2	2.9
INTEL	58.4	88.4
IBM	95.6	129.9
ALL 10	56.8	79.1
OVERALL	PERCENTAGE CHANGE 2000-LATEST**	
R&D SPENDING	+42.1%	
CAPITAL SPENDING	+2.1	

*Capital spending for oil companies includes expenditures for exploration as well

**Latest year for which R&D and capital spending are both available.

***Excluding GE Capital Services

Data: Company reports, BusinessWeek



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One celebrated example is Jonathan Ive, the man who designed the iPod and iMac. Ive was born in England and educated at Newcastle Polytechnic University of Northumbria before joining Apple Computer Inc. in California in 1992.

Ive is not unique. Most of the workers who immigrate to the U.S. each year have at least a high school diploma, while about a third have a college education or better. Since it costs, on average, roughly \$100,000 to provide 12 years of elementary and secondary education, and another \$100,000 to pay for a college degree, immigrants are providing a subsidy of at least \$50 billion annually to the U.S. economy in free human capital. Alter-

natively, valuing their contribution to the economy by the wages they expect to earn during their lifetime would put value of the human capital of new immigrants closer to \$1 billion per year. Either the low or high estimate would make current account deficit look smaller.

These numbers may also seem squishy. Still, if Fed Chairman Ben Bernanke, corporate executives, and ordinary investors want to know where we've been, and where we're headed, tracking the creation and flow of knowledge is the only way to go. ■

—With Steve Hamm in New York
Christopher J. Farrell in St. Paul, Minn.

Tuition: It's Not Like An Ice Cream Cone

Forty-two grand a year. That's the going rate for tuition, room, and board at Vermont's pricey Middlebury College, where Donna Kelly's son and daughter go to school. "It's what we spend all our discretionary income on: education," says Kelly, who lives in St. Paul, Minn. "We look on it as an investment in their lives."

Government number crunchers don't see it that way, though. By their reckoning, the money households lay out for college and other levels of education—an eye-popping \$224 billion in 2005—is consumption, no different than buying an ice cream cone or a new pair of sneakers. Ditto for money plowed into federal job programs, the National Science Foundation (NSF), and even the salary of the local public school teacher who helped your child learn to read.

Imagine if all the money you devote to education, plus the government's outlays for education, training, and R&D, went into the investment column instead. Suddenly, Americans would look a lot less profligate. The U.S. devotes more to education and R&D than most other industrialized countries. For example, America spends well over 7% of gross domestic product on education, compared with 4.6% for Japan. And if the money socked away by households and spent on education was counted as savings, then the U.S. personal savings rate for 2005 would be 2.0%, not the -0.5% the official numbers show.

So why aren't these outlays being categorized as investment? Supplementary accounts for government and business R&D are coming (page 62). But treating education as investment is much farther off, despite the obvious long-lasting nature of the "human capital" asset created by

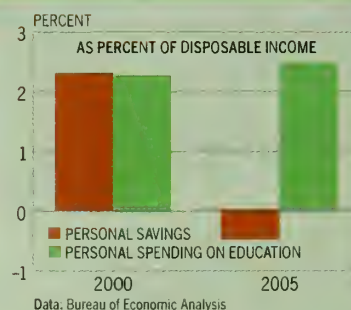
education. After all, the skills learned in school last a lot longer than the typical computer, which is counted as investment by the statisticians.

The reason is simple: There is no consensus, among economists, educators, or, for that matter, broader society on how to measure the value of a dollar spent on education. Should it be valued higher if it raises test scores or results in a higher wage down the road? Should it be valued lower if the kids are taught in a crowded classroom or if the college economics course is taught by a research assistant who speaks broken English? Are high school courses in art appreciation an essential part of the curriculum or a mere frill? These questions

Investing in The Kids

Households are spending more on education even as the savings rate falls

READING, WRITING,
AND CHECKBOOKS



are not merely technical but matters of intense public and political debate, both at the national and local level.

Similar concerns complicate a more rational assessment of the federal budget. The government spends an enormous amount, \$396 billion in fiscal 2005, on long-lived, intangible investment such as R&D and education, as well as such physical assets as computers and jet fighters. So why not take a page from the business world: Separate out investment spending from the day-to-day costs of running the government.

Calculating the budget that way would put the federal government's current operations into surplus, since the investment outlays exceed the total deficit of \$318 billion. What's more, it would become clear that government borrowing was funding investments with a future payoff. In an ideal world, Congress would weigh whether boosting basic research, as President George W. Bush proposed in his State of the Union speech, was worth taking on more debt. Today, by comparison, the NSF is funded in the same appropriations bill as the Justice Dept., so that more money for long-term research may be competing against more dollars for the Federal Bureau of Investigation. That sort of choice encourages short-run thinking.

In the real world, even proposing a shift in operating and investment budgets would scare up a lot of opposition. One fear is that politicians would try to game the system. Says Joseph J. Minarik, research director of the Committee for Economic Development, a research organization in Washington: "Our man's investment is another man's pork-pork being defined as spending that does generate a broad return."

Still, calling things by their right names has clear advantages. Persisting in the fiction that government and household spending on R&D, training, and education is only consumption is to misunderstand the knowledge economy.

—By Michael Mandel in New York
with Christopher J. Farrell in St. Paul, Minn.
and Howard Gleckman in Washington

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Why Junk Bonds Are Getting Junked

Leveraged loans offer better terms, but their floating rates could spell trouble

BY DAVID HENRY

TIME WAS WHEN THE junk-bond market was a vital source of cash for a capital-intensive paper company wanting to borrow billions. Not now. On Jan. 27, Georgia-Pacific Corp. raised \$11 billion with no help whatsoever from the junk market. It got its money from so-called leveraged loans, which are speculative-grade loans secured by company assets.

Companies are flocking to leveraged loans because they're offering the cheapest and most plentiful debt capital in at least eight years—far better than what's available via junk bonds. The terms are so attractive that leveraged loans are pushing aside junk as a key debt instrument for leveraged buyouts. In the past year LBO firms used leveraged loans for all or part of the financing involving retailers Neiman Marcus and Toys 'R' Us, direct marketer Affinion Group, and satellite Internet provider Hughes Network.

The movement toward leveraged loans goes hand in hand with the broader shift in credit markets to jack up leverage and shift risk through new instruments such as credit default swaps and collateralized debt obligations. The trouble is, leveraged loans, unlike regular old junk bonds, have floating interest rates. Typically, the rates are just a few percentage points above the London Interbank Offered Rate, or LIBOR, which is the dirt-cheap rate that banks charge one another for short-term money. The



terms on those loans might seem attractive when they're taken. But if interest rates rise, the result could be disastrous for companies that have taken on too much debt.

And more companies are facing the temptation to leverage up as investors flood the market with capital. Leveraged loans were once traded quietly among bank syndicators and a few institutional investors. Now these loans are attracting gobs of money from hedge funds, pension

funds, mutual funds, and others. Investors funded a record \$295 billion in leveraged loans in 2005, three times as much as in junk bonds, according to Standard & Poor's LCD unit, which gathers market data.

The attraction for investors: floating rates, which they prefer at this point in the economic cycle because they think

that long-term interest rates will be eroding the value of junk bonds. (When interest rates go up, bond prices go down.) What's more, in the event of a bankruptcy, loan holders have a stronger claim on corporate assets than bondholders have.

MONEY SALE

BUT THE EASY MONEY has allowed corporate borrowers to ratchet up their debt burdens to the highest level since 1980. And as the debt burdens climb, companies run greater risks of being unable to service their interest and defaulting on their loans. For now, default rates remain low at 1.5% of issuers, less than half the historical mean, according to Moody's Investors

Service. But Moody's expects default rates to rise to 3.3% in 2006.

The most worrisome part of the leveraged loans explosion is the mounting market for so-called second-lien loans. These loans work like second mortgages on home mortgage consumers, allowing companies to borrow more against their assets—but at interest rates about 1 percentage point higher than first-lien loans. Investors

drawn to the higher yields, are pouring money in. Last year they funded \$16.3 billion of second-lien loans, 25 times the amount in 2002. These loans, notes Steven C. Mankin, managing director at LCD, are used to be lent chiefly for "rescue money" to shore up troubled companies. Now companies are taking on these pricier loans for less pressing objectives.

Ultimately, second-lien loans prove to be too successful for the leveraged loan market's own good. As more companies fund more corporate debt, their higher floating rates drive up their interest expenses, more companies are setting themselves up for default. Martin Fridson, the chief executive of FridsonVision LLC, a New York debt market research service, predicts that this bull market in credit will end like the others have, with massive defaults and investors fleeing. But that probably won't happen before 2008. Default rates on loans take a few years to go bad, Fridson explains. In the meantime, the easy money continues. ■

LEVERAGING UP



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Private Equity Wants To Stay that Way

A public fund wants more transparency—and private equity players are in an uproar

BY ADRIENNE CARTER

PRIVATE EQUITY FUNDS are some of the most secretive investors around. They rarely publicize returns, and they fiercely guard the specifics of the companies they own.

That confidentiality has come under attack in recent years by media outlets and political groups that want public investment funds to disclose their private equity and venture capital holdings. Public funds have largely resisted, arguing for less disclosure rather than more.

Until now. The Ohio Bureau of Workers' Compensation, a state-run fund with \$15.7 billion in assets, is pushing to lift the curtain almost completely. In a complaint filed with the Franklin County Court of Common Pleas on Jan. 13, Ohio Workers seeks approval to publish sensitive data on the private equity funds it owns, including the names of the companies in each fund, their valuations, and how those valuations were derived.

The mere possibility of such disclosure has the private equity world in an uproar.

They fear that the exposure of portfolio-specific data could damage their competitive positions and hurt investment returns. If the Ohio effort succeeds, private equity might decide public investors aren't worth the hassle.

Why does Ohio Workers want to reveal all? Call it scandal management. Between 1998 and 2001, the fund handed \$50 million to a money manager to invest in rare coins. "Coingate" erupted in 2005 after a local newspaper reported that up to \$13 million of the investment may be unaccounted for. The matter is under investigation. On top of Coingate, one of Ohio Workers' hedge fund holdings made a bad bet on interest rates, costing Ohio Workers \$216 million. So the group decided a little sunlight was needed. "We felt it was appropriate to carry the torch as opposed to waiting for someone to force us into something," says Ohio Workers director William Mabe, hired in October to clean up the fund.

Disclosing the data would broaden the interpretation of

Ohio's Freedom of Information which was conceived during the 19 before private equity funds became force they are now. In recent years, eral states, notably California and Te have changed their rules to address public's desire for increased disclosure while balancing the importance of p cy to investment firms. Several s now allow the release of broad re data, the assets in the funds, and c general information. Ohio Worker ready released the names of the spe funds it owns.

PENSION FALLOUT

BUT NO PUBLIC FUND has yet rev nitty-gritty details. Doing so, the ind argues, could hurt private equity f and their investments. Many of their panies are upstarts in niche categori keeping a competitive edge is critical. say. "Putting out their marketing prop or what they're doing in the lab jeopa es the ability of those companies to ceed," says Mark G. Heesen, presiden the National Venture Capital Assn., a group. Moreover, stamping a value company now and publicizing it make it harder for a fund to justify l valuation numbers later on.

Private equity firms have already gun shying away from public en. The Ohio case could further limit th vestment opportunities for public sion funds or shut them out of the class entirely. "Why should a fund money from a limited partner w telling them up front that they don understand their business?" says Jose- Aragona, general partner at VC Austin Ventures.

The fallout from the Ohio case be huge for public pension fund though private equity makes up a fraction of public money—just 2%, billion—experts say it's an importan for diversifying and enhancing re. That's why others are watching the case so closely. The Pennsylvania School Employees' Retirement S sent a letter to Ohio Workers voicing objections, and the Pennsylvania Employees' Retirement S is contemplating filing a with the Ohio court.

Ohio Workers is considering exiting private equity but made a decision. "Disclosure an emerging problem," Mabe. "More states will deal with it, if they have ready." It's a fight that's just started. ■

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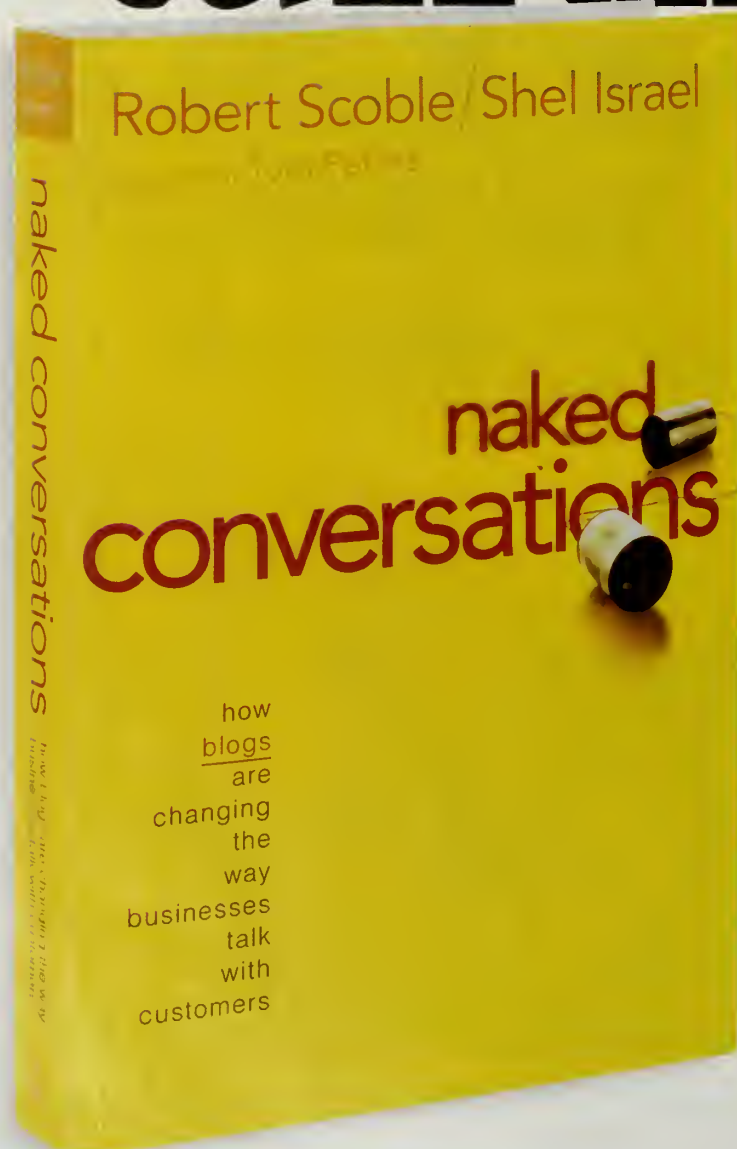
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Selling a Cause? Better Make It Pop

With competition fierce, charities are finding that savvy marketing is a must

BY JESSI HEMPEL

THE EMPIRE STATE Building will glow red for an evening in February. Niagara Falls will run red for a day. And on Feb. 3 newscasters will don red dresses. It's all part of a grassroots campaign to remind women of heart disease risks that has drawn employees at thousands of companies to hand out Red Dress pins plugging the American Heart Assn.'s National Wear Red Day. Credited by marketing hustle worthy of a car rollout, recognition of the pin has come to rival awareness of the pink ribbon as a symbol of breast cancer research. With big-name endorsements and flashy events, the "Red for Women" effort uses all the tricks of a big campaign for a shampoo or an SUV. Increasingly, nonprofits are finding it's a game they must play. Amid an explosion of causes competing for attention, even established charities like American Heart had to rewrite their fund-raising books to cut through the din. A decade ago marketing was a foreign word to most nonprofits. Donors judged a group's success by how much of its budget went to good works vs. fund-raising. Susan G. Komen Breast Cancer Foundation changed the landscape, positioning itself as a favorite marketing partner of big companies. General Motors donated to Whirlpool Corp., bringing annual revenues to \$80 million in 2005. Many nonprofits have been slow to follow. The M-word was not



THE AHA Local news celebs on the catwalk at a "Boston Goes Red for Women" luncheon

considered a good thing," says Tom Peterson, vice-president for marketing at Heifer International, an anti-poverty group that lets you send animals to the needy via catalog. It recently landed an appearance for one of its goats on NBC's *The West Wing*. Says Peterson: "It was as if we were losing our soul."

That view is changing now that there are more than 1.2 million nonprofits, spurring stiff competition for support. Not even the 82-year-old AHA can depend on its name recognition to survive. At American Heart, fund-raising had long been a grassroots activity. Volunteers organ-



HEIFER INTERNATIONAL The anti-poverty group nabbed a mention on NBC's *The West Wing*

ized walks, and folks raised money from neighbors. Then, eight years ago, Wall Street veteran M. Cass Wheeler became CEO of the Dallas-based group. Armed with consumer research, he woke the place up to marketing. "People trusted [that] we did what we did well, but they were not sure exactly what we did," recalls Wheeler. Moreover, while women walked and raced and cooked to fight breast cancer, few understood it was heart disease that was more likely to kill them.

Wheeler cut the 56 field offices to 12 and built a marketing department. The AHA had previously relied on free public service announcements. But competition for the shrinking pie of free ads has become fierce. So, starting in 2003, Wheeler invested \$12

million with ad agency Campbell-Ewald Co., best known for handling Chevy cars and trucks. TV ads, posters, and pamphlets with folks who had lost loved ones to heart disease were wrapped around a new slogan, "Learn and Live," replacing the ossified "Fighting heart disease and stroke." Says Campbell-Ewald President Jeff Scott: "It's more of a call to action."

Spending money to advertise has paid off.

Public support for American Heart reached \$540 million in 2005, up from \$326 million in 1998. In two years, some 366,833 people have logged on to the Learn and Live quiz (at american-heart.org), which helps people identify heart attack risks. Meanwhile, Wheeler hired marketing agency Cone Inc. to design the "Go Red" campaign. With about \$1.5 million behind it over two years, it has returned \$40 million in contributions and drawn activists from more than 9,500 companies.

Of course, nonprofits considering big branding initiatives walk a tightrope. While they need to get noticed and show marketing savvy to companies whose support they seek, good causes can't appear too slick. Nonprofit umbrella group Independent Sector found that charities operating too much like businesses turn off potential donors. Ruth A. Wooden, president of nonprofit think tank Public Agenda, says organizations need to adopt what she calls the Pier 1 strategy. "It's got to look modern and hip," she says, "but it can't be too expensive." ■



The New Ethics Enforcers

These corporate cops have unprecedented power to throw their weight around

BY JOSEPH WEBER

WITH ROCK MUSIC pounding and lasers painting a brilliant light show on giant screens behind him, Patrick J. Gnazzo restlessly paced the broad stage at the Venetian's convention center in Las Vegas. Because he is the new chief compliance officer at Computer Associates International Inc., Gnazzo's presentation was one of the main events just before CA World, the company's annual sales extravaganza. Striding before 1,200 CA staffers, the

blustery 59-year-old former chief trial attorney for the U.S. Navy took a page from tent revivalists, leading a call-and-response chant: "What happens at CA World," Gnazzo shouted, as the crowd echoed his words, "can make us great." Winding up his talk, he exhorted: "Don't lie, don't cheat, don't steal!"

CA staffers can thank the Justice Dept. for Pat Gnazzo. To avoid a criminal trial over alleged accounting fraud, CA accepted a deferred prosecution agreement in late 2004 that required it to set aside \$225 million for shareholders and impose a variety of reforms, including hiring an internal cop to prevent future chicanery.

The job went to the Jesuit-trained Gnazzo, who once considered the priesthood but instead opted for the law. At the \$3.5 billion-a-year Isla (N.Y.) management-software provider reports directly to the board's audit committee, as well as to the general counsel and can buttonhole any manager or chief executive officer on down. "I have unfettered access," says Gnazzo, who earned total compensation in excess of \$675,000 last year.

Gnazzo is among the more visible examples of a new species of executive: the former government lawyers and judges who have been tapped, usually from scandal-tainted companies, to police employees (table). Others in this group include former Securities & Exchange Commission Chairman Richard C. Breidenbach, who was named outside monitor of Kmart in August and is now taking a similar role at Hollinger International Inc. Ed Dinallo and Beth L. Golden, alumni of New York Attorney General Eliot Spitzer's office, have taken jobs at Morgan Stanley and Bear, Stearns & Co., respectively.

GNAZZO At CA, he's part father confessor and part cop

BusinessWeek online For more on ethics officers, and a Q&A with Richard Breidenbach, go to www.businessweek.com/extras

The last need of ethics chiefs don't top fraud

G moved to stem an embarrassing shelter sales scandal. He can review confidential internal documents, interview any official he wishes, and even fire executives whom he believes are guilty of fraud.

While titles and responsibilities may vary, all have unprecedented power to throw their weight around, much more than a typical ethics officer or in-house compliance chief. Breeden, for example, was installed for a three-year term after

ations in 45 countries. During his tenure, Gnazzo's group has handled more than 100 cases and taken "corrective actions"—including a "substantial number" of firings—against 70 staffers. (Gnazzo declined to discuss the details of these inquiries.)

Gnazzo, who feels duty-bound to decline most invitations for after-hours socializing with colleagues, is often tapped for informal advice. Recently a senior CA executive was troubled that an outside business associate, learning of his son's passion for a certain rock band, bought concert tickets and sent them as a gift. Arguing that this

news releases. One issue Gnazzo has discussed with senior management: whether so-called side-letter deals—the arrangements outside of formal sales contracts that can lead a company into trouble—are appropriate (in rare cases, Gnazzo says, the answer is yes).

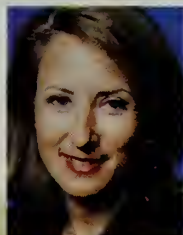
Some argue that the new set of inside cops has too much power. Members of the criminal defense bar fret over what one group, the National Association of Criminal Defense Lawyers, calls "unprecedented levels of ongoing prosecutorial oversight" over corporate decision-making.

But Gnazzo tries to operate with a lighter touch. While it is his responsibility to police managers, he tries not to be perceived as an outsider. Even though he has the ability to go over Swainson's head, for instance, Gnazzo doesn't expect he'll need to do so. "I've never been in a situation where I had to do anything more than to say to a CEO, 'You know you did something I don't think is right,'" he says. Typically, he adds, senior managers discreetly quizzed about, say, potential sexual harassment or expense-report problems straighten out quickly if they want to keep their jobs.

Gnazzo would rather prevent

headaches than punish miscreants, an approach that demands discretion. While at UTC, he says, a staffer complained that an executive planned to make a flawed presentation to high-level managers. "I know we're faking the numbers," the staffer told Gnazzo, adding that his boss was making him "fake the numbers to our own senior managers."

Without suggesting there was a whistleblower, Gnazzo diplomatically reminded the executive that inaccurate presentations wouldn't pass muster. The result: The executive fixed the presentation before delivering it, Gnazzo never had a problem with him, and the staffer escaped recrimination. Like a cop on a beat who handles a problem without making arrests, he says, "I had to work it very sideways." ■



Inside Cops

Computer Associates isn't the only company that has brought on board high-profile law enforcers:

AIG New Chief Compliance Officer Mari B. Maloney boasts experience at both the NASD and the Manhattan D.A.'s office

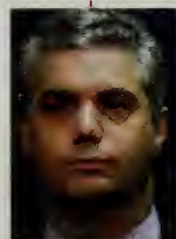
BEAR STEARNS Hired **Beth L. Golden**, who worked alongside New York Attorney General Eliot Spitzer in his Wall Street probes, in June, 2004

BRISTOL-MYERS SQUIBB Former federal judge Frederick B. Lacey will serve as the company's independent monitor until August, 2007

KPMG Former SEC Chairman **Richard C. Breeden** was named outside monitor for the accounting firm in August

MARSH McLENNAN Created post of chief compliance officer in January, 2005, naming former assistant U.S. Attorney E. Scott Gilbert to post

MORGAN STANLEY Named **Eric R. Dinallo**, formerly chief of the investment protection bureau for Spitzer, as chief compliance officer in 2003



DOW DRESSING?

ULATORS are counting on Gnazzo, Breeden, and their ilk to bring a genuine change in corporate behavior. But will they be more effective than the corporate cops who preceded them? Outsiders, ethics honchos, compliance managers, after all, have not proved to be an obvious deterrent to wrongdoing. Enron boasted an unusually detailed 62-page code of ethics that was aimed at helping protect the outfit's "reputation for fairness and honesty," as former Chairman Kenneth L. Lay put it.

While corporate cops can never put an end to fraud, there's good reason to believe that the breed are going to be much more than just window dressing. Gnazzo, with their résumés. The previous generation of compliance officers tended to come up through the ranks of human resources and had little visibility inside or outside their companies.

By contrast, Gnazzo, the former president for business practices at Computer Associates Corp., arrived at CA with a well-established reputation and a long-standing store of credibility with government officials.

Now that he has been at CA for just a year, Gnazzo agreed to discuss his position in detail with *BusinessWeek*. As first compliance officer in the history of the company, he is in the process of building a big team. His 14-member department is about to be supplemented by 20 compliance deputies, who will provide local eyes and ears in CA's oper-

ations was worlds apart from joining a client in a stadium guest box where business could be discussed—an acceptable invitation—Gnazzo advised the man to pay for the tickets.

Old-style ethics officers reported to managers far down the ladder. Gnazzo has the power to go right to independent directors with problems. Whenever needed, he can quiz CEO John Swainson, the former IBM vice-president who joined CA to clean it up. He also confers regularly with the CEO and five other top officers on a new disclosure committee that meets to talk about SEC filings and

No Union, Please, We're Wal-Mart

How the retail giant fought back when labor got a toehold in a Quebec store

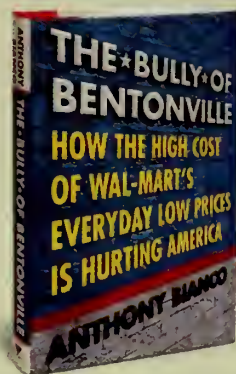
BY ANTHONY BIANCO

IF WAL-MART FOUNDER SAM WALTON HAD BEEN prone to nightmares, they probably would have looked a lot like the big-box store in Jonquière, Que., on this Friday evening in April, 2005. Empty shelves outnumber full ones by about 5 to 1. Whole sections are closed, and the remaining merchandise consolidated in the center of the store. The entire contents of the baby department now fits into a single shopping

left in the middle of an aisle. Some 20 workers shuffle about forlornly in their blue smocks, tending to a dozen customers searching for a final bargain among the dregs of what had been great abundance just a few weeks ago.

Here in Jonquière, the ubiquitous Mr. Smiley Face, mascot of Wal-Mart Stores Inc., seems downright deranged. "This is not what a Wal-Mart is supposed to look like," admits Marc St. Pierre, the store manager.

St. Pierre sent the store's greeters home long ago. In their place are two uniformed security guards who ignore the departing customers (Wal-Mart might welcome shoplifting as a form of accelerated retail euthanasia) to focus their attention on new arrivals. No doubt they would confiscate a gun if they saw one, but what they are really looking for is cameras. A skeleton crew of downcast employees wandering around a shambling of a store is not an image that top management in Bentonville, Ark., wants to see splashed across newspapers or magazines. A third security guard patrols the parking lot in a silver SUV, keeping an eye out for shutterbugs. Photographing the outside of the store is allowed, but try to bring a camera inside and a longhaired young man will politely but firmly bar your way.



I didn't come here to take pictures or to buy a Montreal Canadiens salt and pepper shaker for \$1.89. As I'm checking out, the elderly man in front of me says to the young woman running the register: "It's so sad to see your favorite store like this." She just shrugs.

On the way to my car, I encounter a man who appears to be in his 60s ambling toward the store's entrance. Is he here to buy some "No," he replies, with a derisive snort. "I'm here to look at the corpse."

"Remote" is an adjective that does not belong in Jonquière. This rough-hewn, claggy city of 60,000 sits at the edge of inhabited

land. To the north is nothing but forest, mountain, and bay all the way to the Arctic Circle. Quebec City is a three-hour drive south, through a wilderness preserve where moose easily outnumber men and make highway driving an adventure.

A media capital Jonquière is not. And yet Wal-Mart's dominance of this north Quebec outpost in the spring of 2005 made news from Tokyo to São Paulo as an object lesson in lengths to which America's largest company will go to to avoid the threat of unionization. Wal-Mart closed its store here in April, months after it was certified by the Quebec government as the only unionized Wal-Mart in North America.

Canada is important to Wal-Mart, which, with 260 stores, is the country's second-largest retail chain. Although the "Every Day Low Prices" is as strong above the 38th parallel

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low it, the Canadian shopper is far more likely than her U.S. counterpart to belong to a union. Nearly 29% of Canadian workers carry a union card, compared with 13% of American employees. Labor laws in Canada are more favorable to unionization and are more likely to be vigorously and expeditiously enforced—especially in Quebec, where the unionization rate is a robust 40%.

Wal-Mart entered Canada by buying 122 discount department stores from the Canadian subsidiary of Woolco in 1994. (Wal-Mart passed on 22 other Woolco stores, including all 10 of its unionized outlets.) One was in Chicoutimi, which is a kind of white-collar cousin to the blue-collar mill town of Jonquière. In 2001 these two adjacent cities and four smaller towns merged to form Saguenay, which is the largest city in the Saguenay-Lac-St.-Jean region of Quebec. It was just about this time that Wal-Mart entered Jonquière, much to the delight of its residents. The opening of the Place du Royaume shopping mall in Chicoutimi a decade earlier had wiped out many stores in Jonquière, leaving a void that the new Wal-Mart went a long way toward filling. The 190 jobs that the store brought were equally welcome in an area chronically afflicted by high unemployment.

Even so, a company as anti-union as Wal-Mart was pushing its luck entering Jonquière, the Quebec union town *par excellence*. The isolation of Saguenay-Lac-St.-Jean bred a defiant independence of spirit into what is still a remarkably homogeneous population. Nowhere in the province is support for Quebec sovereignty—separation from English-speaking Canada—stronger than among the Saguenay's French Catholics, every fifth one of whom seems to be named Tremblay. The region is heavily industrialized; each of the aluminum smelters and pulp and paper factories that dot its ruggedly scenic landscape has been unionized for decades. The Quebec labor movement was more or less born in the Saguenay, and a tumultuous birth it was. In 1942 the army had to be called in when a strike at an Alcan Inc. plant spun out of control.

The sentiment that drove Wal-Mart's Jonquière workers into the arms of the United Food & Commercial Workers (UFCW) is best summed up by a bitter pun popular locally. Quebec's official motto is *Québec, je me souviens* ("Quebec, I remember"). The workers adapted this to Wal-Mart, *je me soumetts* ("Wal-Mart, I submit"). Says Sylvie Lavoie, a 40-year-old single mother who led the worker rebellion in Jonquière: "Wal-Mart will only choose somebody for promotion who thinks Wal-Mart, sleeps Wal-Mart, and eats Wal-Mart, and who puts Wal-Mart before absolutely everything—before their family even." Like many of her colleagues, Lavoie stood silently through the mandatory Wal-Mart cheer each morning. "It's not a song. It's a military chant," she says. "I found it to be degrading."

A FIESTY CASHIER

It is just after 8 o'clock, and Lavoie is sitting behind a desk in a union hall less than a mile from the dying store where she worked for four years. Today is the final day for the workers Wal-Mart fired to register for a financial-aid program set up by the UFCW. The union has offered to make up the difference between a worker's unemployment check and



"THE CORPSE" In Jonquière

other job is found—no small challenge for Jonquière. Lavoie, who is unemployed herself, is here bright and early to with an expected last-minute rush as a sense, to finish what she started.

A pretty, vivacious woman with bleached brown hair and a tiny diamond stud in her left nostril, Lavoie is dressed in blue jeans and a white cowl-neck sweater. Lavoie was tending bar in Jonquière when the Wal-Mart store opened. She started as a part-time clerk in the ballroom department and soon became a cashier in a store that bustled with activity right from the start. Although I liked Wal-Mart at first, she was never to deny her supervisors the benefit of my point of view. "I am not a troublemaker,"

she insists. "But maybe I had a little more character than them in saying: 'Look, perhaps there is a fault in the system.'"

As a part-timer, Lavoie did not qualify for health insurance and was almost always stuck working weekends while her husband took care of her little daughter, who was not happy about her mother's absences. She repeatedly applied for the full-time cashier jobs that regularly came open and grew increasingly enchanted as they were filled by co-workers or by new hires. One day an assistant manager called Lavoie in and congratulated her on being selected for a full-time storeroom job for which she had not applied. She refused to take it. As the cashiers got to work and trust one another, they began comparing notes and demanding major pay inequities within their ranks. One day, Lavoie led a delegation of cashiers to the manager's office to complain. "We were a big bunch of girls, and we all went together," she recalls. "He laughed in our faces."

For Lavoie, the last straw came when she and her best friend, a part-time cashier supervisor named Johanne Desbiens, both turned down promotions on the same autumn day in 2003. "Johanne came over to my place, and she was really angry," Lavoie recalls. "I was a little harder than her; I didn't want it so badly. I just looked at her and said: 'Well, Johanne, nothing else to lose.'"

Andrew Pelletier, Wal-Mart Canada's chief spokesman, says that he has no information about Lavoie's complaints and does not respond to them. However, he adds, "the scenario described does not sound at all like the way we operate."

The first approach to the UFCW had already been made in 2002 by three of the store's minority of male workers. However, it wasn't until Lavoie and Desbiens signed on that the campaign gained traction, says Herman Dallaire, an organizer for UFCW Local 503 in Quebec City. "The difference was they were cashiers, which is a big department in the store and much more popular with their co-workers," Dallaire says. "We also had very strong personalities and were not afraid of store managers."

In Quebec, unlike the U.S., a store can be unionized without an employee election. If a majority of the hourly workers sign union cards and if those signatures then are certified by the provincial government, the law requires management to negotiate with union representatives and negotiate a collective bargaining agreement. If no agreement is reached, a government-appointed arbitrator can impose a contract. In Quebec,

s moves along with an alacrity that tends to blunt the sort-union tactics Wal-Mart puts to such effective use in the fact, if the necessary number of signatures can be collected covertly, a store can be unionized before management knows a drive is under way.

on officials kept their distance while Lavoie and a handful ers began meeting outside of work with colleagues they o be dissatisfied with their pay and working conditions. ion was essential, for they knew that there were workers ther truly liked their jobs without benefit of a union or o fearful of losing them that they would oppose union- Of the store's 190 employees, 45 were salaried man- leaving 145 workers in the prospective bargaining unit. store soon was riven into bitterly opposed camps. Man- ant began holding mandatory anti-union meetings and is- lire warnings about the future of the store. Complaints of lation and harassment cut both ways, as pro-company ees told of organizers pestering them at home at all Some workers "signed the cards just to get some peace," oëlla Langlois, a clerk in apparel. "They thought they vote against [unionizing] in a secret vote."

USED BY THE UNION?

he UFCW fell one signature short of the required number for automatic certification and decided to take its chances by petitioning for a secret vote in April, 2004. The move backfired, as the union was voted down 53% to 47%. A group of managers gathered outside the front door to celebrate for the TV cameras ant union supporters as they left the store. Many workers d voted against the union were so appalled by this spec- at they switched sides.

the required three-month cooling-off period expired, and her allies started over and collected a surfeit of sig- so quickly that this second campaign succeeded before ment even realized that it was afoot. The Jonquière store automatically certified as a UFCW shop in August, 2004, a big boost to the union's organizing gins in two dozen other Wal-Mart stores Canada.

months later, just as the UFCW and Wal- representatives were preparing to begin tory contract negotiations, Wal-Mart issued an ominous press release from its arters near Toronto. "The Jonquière not meeting its business plan," it de- "and the company is concerned about ionic viability of the store." Nine days of

tion between the UFCW and Wal-Mart produced nothing mony. "When we got to working hours and schedule, it ver, never, and never," recalls André Dumas, now the act- sident of UFCW Local 503 in Quebec City. Honoring demands would have meant adding 30 workers to the counters Wal-Mart's Pelletier. "We felt the union want- damentally change the store's business model."

ie and Desbiens were playing bingo on Feb. 9 when a TV rt called seeking comment on Wal-Mart's announcement as closing in Jonquière. They were stunned. It had nev- red to them that Wal-Mart would go so far as to shut n store that seemed to be busy all the time. Lavoie began tily calling friends currently on duty but learned nothing u "They were all crying," she says.

Wal-Mart's draconian response to the Jonquière unionists

scandalized Quebec. Three of the company's other 46 stores in the province were temporarily closed by bomb threats. A TV broadcaster likened Wal-Mart to Nazi Germany and then apologized. Jean Tremblay, the feisty, populist mayor of Saguenay, gave media interviews by the dozen denouncing the company as a freebooting scofflaw. "Because you are big and rich and strong, you can close a store to make your workers in other stores afraid? No!" Tremblay said. "If you want to do business in Quebec—or in Russia or in China—you have to follow the law. And you have to respect the culture."

From his office in Ontario, company spokesman Pelletier insisted that the reasons Wal-Mart gave up on Jonquière had nothing to do with stifling unionism. The store "has struggled from the beginning," he said. "The situation has continued to deteriorate since the union." In Bentonville, H. Lee Scott Jr., Wal-Mart's CEO, seconded Pelletier in a *Washington Post* interview. "You can't take a store that is struggling anyway and add a bunch of people and a bunch of work rules," Scott declared.

To which the people of Canada responded nearly as one: "Liars." A national survey by Pollara Inc., Canada's largest polling organization, found that only 9% of Canadians believed that Wal-Mart closed the store in Jonquière because it was struggling financially. In the opinion of 9 of 10 Canadians, it was all about the union. Some 31% of those queried said that they would either do less shopping at its stores or stop going to them altogether—a figure that rose to 44% among Quebecers. In another survey taken six months after the Jonquière pullout, Quebecers ranked Wal-Mart 11th out of 12 retail chains when it comes to meeting their needs and expectations.

In Jonquière today, hatred of Wal-Mart coexists with resentment of the UFCW. Carol Néron, a local newspaper columnist, is convinced that the union leaders in Washington knew that Wal-Mart wouldn't tolerate a unionized store in Jonquière and provoked a fight there only to incite public opinion against the company. "Many people, myself included, think that our people have been used as cannon fodder," Néron says.

Under Quebec law, a company is legally entitled to shut down a store or a factory for any reason—even to thwart unionization—

"Anybody connected to Jonquière knows how hard we tried to save the store," says a Wal-Mart official

as long as the closure is permanent. Wal-Mart recently has cancelled its long-term lease of the building it occupied in Jonquière, eliminating any possibility that the store will reopen. The fired workers' best hope for monetary compensation from Wal-Mart is a pending class action suit alleging violations of the Canadian Charter of Rights and Freedoms. The Quebec Court of Appeals will hear the case in March. "Anybody connected to Jonquière knows how hard we tried to save the store," Pelletier says.

In the meantime, finger-pointing and second-guessing no doubt will persist within the ranks of Jonquière's former Wal-Mart employees. Not long ago, Lavoie's 10-year-old daughter came home crying from school after she had been harangued by the child of a former Wal-Mart manager. A hero to some and a villain to others, Lavoie insists that she had no choice but to fight. "*Je ne regrette rien*," she says. "I regret nothing." ■

Black Art Is Buried Treasure

In an overheated market, works by African American painters are a bargain—for now. **BY THANE PETERSON**

(L-R) PHOTOGRAPHS COURTESY OF GRANT HILL; COURTESY OF SWANN GALLERIES

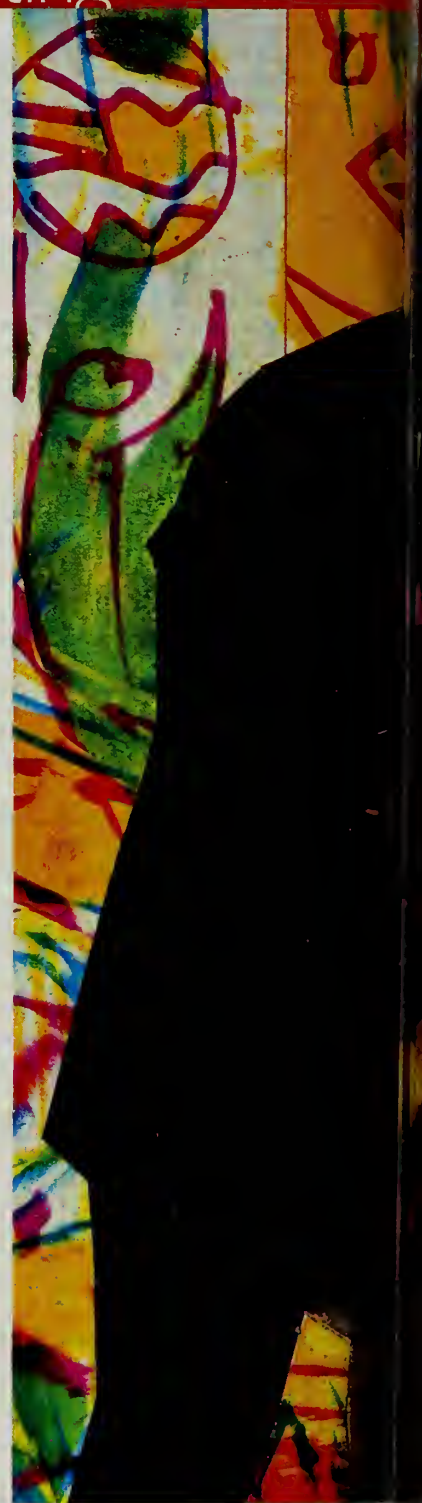
FOR ART COLLECTOR JOHN AXELROD, the epiphany came a dozen years ago at a New York gallery show of works by African Americans. The Boston lawyer, now retired, was stunned. “My feeling was, these are not African American artists, these are great artists from the country and period I collect in, and I don’t know about them.” Today about 90 of the 320 pieces he owns are by African Americans. ¶ That, in a nutshell, is what many black collectors think will happen as more white collectors become familiar with the

paintings, collages, sculptures, and photographs of African Americans. Wealthy African Americans are usually heavy buyers at the National Black Fine Art Show (Feb. 2-5 at the Puck Building in Manhattan), in part because they want to support work they believe doesn’t get enough attention. But in an art market where prices seem badly inflated, collectors have economic reasons to be buying, too. “There isn’t much else to collect that hasn’t been overexploited,” says David Driskell, the art professor emeritus at the University of Maryland who helped Bill Cosby and his wife, Camille, amass their collection. Pre-

dicts Atlanta art dealer Jerry Thomas Jr.: “In the next 10 years we’re going to see a very significant appreciation in the price of African American work.”

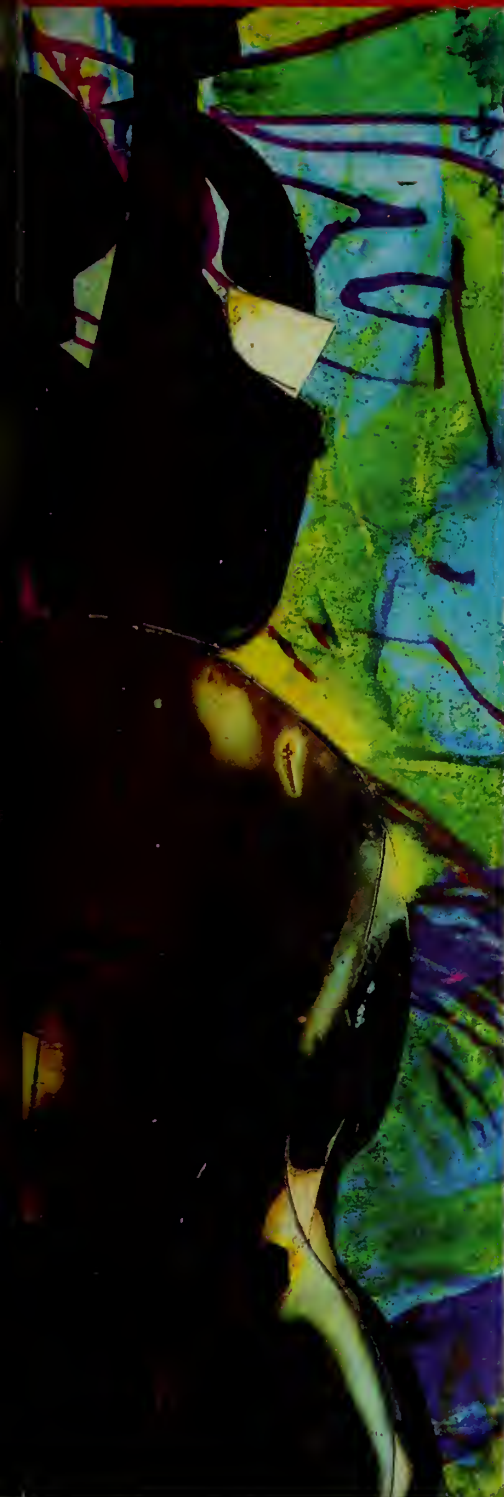
ON THE PROWL

THERE ARE ALREADY long waiting lists of collectors eager to pay a fortune for works by Chicago’s Kerry James Marshall, New-York-based Kara Walker, and Jean-Michel Basquiat, who died in 1988 at the age of 27. But Driskell contends that prices still lag badly for African American masters such as Henry Ossawa Tanner (1859-1937), Romare Bearden (1914-88),



TIME FOR BASS, 1979 The National Gallery of Art organized a retrospective of Romare Bearden’s career in 2003

Jacob Lawrence (1917-2000), and EBETH Catlett, 90, because they remain under-represented in mainstream galleries and museums. Indeed, even after a Bearden retrospective organized by



Neonal Gallery of Art in 2003, the art's pioneering collages still can be purchased for well under \$100,000. "Burden is the most undervalued artist in America right now," says Miami collector Donald Rubell.

Prices for those artists' works seem likely to rise. E.T. Williams, a retired painter and real estate investor who is on

the board of the Brooklyn Museum of Art, says "a major catch-up" is under way as mainstream museums give African American artists more wall space and new museums such as San Francisco's Museum of the African Diaspora (which just opened in December) are built. That's already giving a boost to older artists, such as abstract painter Sam Gilliam, 72, the subject of a retrospective organized by Washington's Corcoran Gallery that will be moving on to museums in Louisville, Savannah, Ga., and Houston. The Art Institute of Chicago is running a major Catlett show through Apr. 23.

NBA PICKS

MEANWHILE, a new generation of collectors is scouting talent. Professional basketball star Grant Hill, 33, who has built a museum-quality collection of black old masters (you can see it at granthill.com), plans to focus on younger living artists after he retires. Two of his friends, retired NBA player Elliot Perry, 36, and Darrell Walker, 44, an assistant coach with the New Orleans Hornets, are already purchasing pieces from emerging mixed-media artists such as Whitfield Lovell, 46, and Radcliffe Bailey, 37.

These collectors haunt galleries such as D.C. Moore, Michael Rosenfeld, and Bill Hodges in New York and G.R. N'Namdi (which has locations in Detroit and Chicago as well as New York). They also track shows by hip curators at institutions such

as the Studio Museum in Harlem and get to know the artists. "We know that one day we'll go down in history as collectors," Walker says. It may pay to follow their lead. ■

BusinessWeek online NBA stars Grant Hill and Chris Webber talk about their collections at businessweek.com/extras

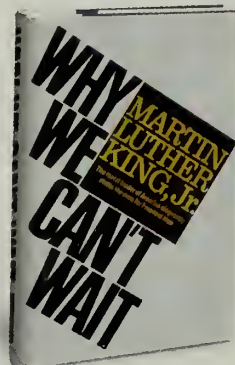
Tracking African Americana

Books and other artifacts are rising in value, too.

BY THANE PETERSON

MIKE GLENN OF Atlanta has been collecting African Americana only since 1997. But he figures it already would be tough to replicate his assemblage of photographs, artifacts, and some 2,000 rare books. "I have things that are unavailable now and that if I could find, I could never afford," says Glenn, a former pro basketball player who is now commissioner of the minor league World Basketball Assn.

Glenn isn't the only collector in the field experiencing sticker shock. Demand for these objects is soaring, in part because of the rising affluence of African Americans. Many celebrities, including Whoopi Goldberg, Oprah Winfrey, and star Philadelphia 76ers basketball player Chris Webber (chriswebber.com), are collectors. Webber, 32, who grew up in inner-city Detroit, says he got the bug back in high school when he attended suburban Detroit Country Day School. "I met people from every ethnicity imaginable, and I saw how they took pride in their



AT SWANN'S This 1964 first edition, signed by King, is expected to fetch \$8,000 to \$12,000

history," he says. "It wasn't racial pride. They just held their traditions close."

Also fueling demand are many white collectors as well as museums and universities that once neglected African American history. Duke, Emory, and the University of Virginia all are adding to their collections, as are historically black Fisk and Howard universities and New York City's Schomburg Center for Research in Black Culture. "Forty years ago, African Americans couldn't walk across this campus unless they were on the janitorial staff," says Randall Burkett, curator of African American collections at Emory University in Atlanta. "We hope to build a collection that will show what a different place this is now."

18TH CENTURY RARITIES

NOT SURPRISINGLY, the prices of iconic pieces are soaring. On Nov. 22 an extremely rare 1776 letter by the poet Phillis Wheatley sold for a record \$253,000 at New York's Swann Auction Galleries, while a signed first edition of Wheatley's 1773 *Poems on Various Subjects*, the first book of poetry published by an African American, is estimated to go for \$30,000 to \$40,000 at Swann's annual African Americana auction scheduled for Feb. 28, up from perhaps \$10,000 tops 10 years ago. Swann figures a signed first edition of the 1855 narrative by the escaped slave and abolitionist leader Frederick Douglass will sell for \$20,000 to \$25,000, vs. about \$15,000 at most a decade ago. Some dealers believe both will go for far more.

Prices of more recent historical items are rising fast, too. Material from New York's Harlem Renaissance of the 1920s and '30s is hot. So is just about anything connected with boxer Muhammad Ali, Black Muslim leader Malcolm X, the Black Panther Party, and Martin Luther King Jr. Auction house Swann thinks a signed first edition of King's 1964 book *Why We Can't Wait* will fetch \$8,000 to \$12,000, while a cardboard placard emblazoned with the slogan "I am a Man" from King's last 1968 march in Memphis is expected to go for \$700 to \$1,000.

BIG DRAW Swann's figures this signed 1855 Douglass manuscript will go for \$20,000 to \$25,000



AT CHRISTIE'S
A painted cast iron clock from the estate of Bobby Short

Major collectors, such as Los Angeles' Bernard Kinsey, a retired Xerox executive, and his wife, Shirley, attempt to document the whole sweep of African American history. Among the rarities they own are a 1710 treaty between Great Britain, France, and Ireland divvying up which countries would take slaves from where. More recent material includes a letter from Malcolm X, two years before his 1965 assassination, telling co-author Alex Haley that he wanted to hurry and finish his autobiography.

Other collectors develop specialties. Bill Cleveland, a prominent Atlanta kidney doctor, has over the years obtained most of the recordings of jazz great Duke Ellington. He also has a stash of Ellington's letters as well as two huge portraits of the musician by Simmie Knox, who painted the official White House portrait of former President Bill Clinton. A network of friends alert Cleveland to choice items, such as a box of Christmas cards

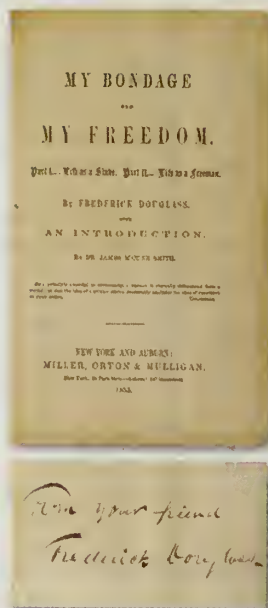
and other memorabilia he got for about \$2,000 from one of Ellington's Washington (D.C.) neighbors. Mike Glenn has a collection of old photos, books, and other sports items documenting the forgotten accomplishments of early black athletes such as the boxer Tom Molineaux, an enslaved man who fought the English champion Tom Cribb in 1810 and 1811, and Moses Fleetwood Walker, who integrated baseball in the 1880s, decades before Jackie Robinson hit the majors in 1947.

As with any form of collecting, there are pitfalls. For instance, collecting shackles and other slavery paraphernalia is controversial because many see it as trafficking in instruments of human bondage. There's also a high risk of fakes since it's tough to determine

which items were connected to slavery. Another minefield is eBay, especially for collectors of popular-culture items such as vintage cookie jars, figurines, and other objects that stereotype blacks. Collectors of this material have included Goldberg, NAACP Executive Chairman Julian Bond, and the late entertainer Bobby Short (check the Feb. 16 auction of Short's estate at Christie.com). There's plenty of these items on the auction site. Trouble is, says Leonard Davis, a New York fashion designer and contributor to the *Black Americana Price Guide*, many items are reproductions. On the plus side for purchasers, eBay has driven down the cost of the real stuff by making it easy to sell. "Someone gets \$200 for an ashtray and before you know it, 200 ashtrays show up on eBay for \$50 apiece," he says.

So bone up before you buy. Read the Swann sale catalog and attending the annual Black Memorabilia & Collectible Show and Sale in Gaithersburg, Md., Mar. 25 are good ways to learn. Catalogs from rare book dealers, such as William Reese in New Haven, McBlain Books in Hamden, Conn., and Between the Covers Rare Books in Merchantville, N.J., are also helpful resources. Good primers on the subject include *The Art and History of Black Memorabilia* by Larry Buster and *Collecting African American History* by Elvin Montgomery.

"There are still gems out there that can be found for next to nothing," says Charles Blockson, the collector and curator at Temple University in Philadelphia who has amassed a major collection at the school. And with demand for African Americana rising, what you acquire will probably gain value over time. ■





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Private REITs Dividend Draw

BY CHRISTOPHER FARRELL

UNTRADED REITS ARE like the real estate investment trusts that trade on the market. Both pool cash from commercial properties, pay out a 90% of their income in dividends, and register with the Securities Exchange Commission.

Their differences, though, are stark. The price of a share of an unlisted REIT—also called a private REIT—is set by the sponsor, and it doesn't fluctuate. A public REIT that sells for \$10 a share in February will be worth \$10 a share in February next year. Unlisted REITs last for a fixed time period, typically 10 to 12 years. Investors then cash out through a public offering, a merger, or a liquidation. Dividends are now in the 6% to 7% range, vs. an average 4.7% for public REITs.

Although investor buying has slowed recently, sales of unlisted REITs have grown elevenfold since the stock market tanked in 2000. And of course, real estate prices surged in that period. "The lack of volatility appeals to older investors," says Robert Lee, a certified financial planner in Fairfax, Va. "They like to see their portfolio grow steadily and get a 6% to 7% dividend yield."

Critics charge that the stable price and steady income have a steep price tag. Sponsors such as Wells Real Estate, W.P. Carey, the Inland Group of Real Estate Cos., and CNL Financial Group charge lots of fees. Typically, only 84¢ of every \$1 gets invested. The fees go to the sponsor and to the broker-dealers and personal financial planners selling the REITs. (Commissions are in the 8% to 9% range. In contrast, you can buy public REITs as little as a \$10.99 commission at a discount line broker.) Says Christopher Milstein, director of the Milstein Center for Real Estate at Columbia Business School, "It's hard to imagine these are a good alternative to paying for a public REIT with its little transaction costs."

Another drawback is the illiquidity. While getting in for as little as \$10 is easy, getting out is tough. Redemptions are typically limited to no more than 1% of the entire fund. Sponsors can suspend redemptions at any time. In general, the shorter the holding period the

Getting a Slice of the Commercial Market

Unusual property plays may look promising, but beware the high fees and lack of liquidity

The boom in commercial real estate has stirred interest in some unconventional plays. Two of them are unlisted real estate investment trusts and tenant-in-common deals. Together last year they scooped up around \$14 billion worth of assets. The pitches are enticing: Unlisted REITs promise stable valuation, while TIC sponsors offer a tax shelter for capital gains. But is either right for you? Fees are high, and it's easier to get in than out. Here's a look at both:

surrender charge. For instance, in the REIT 11 offering of 2003, an investor can redeem a limited number of shares after a year of ownership at \$9.10 per \$10 invested. Three years later, the formula changes to 95% of the estimated value of shares.

Untraded REITs are successors to the state limited partnerships that were popular as tax shelters during the real estate boom of the 1970s and early 1980s. The limited partnerships collapsed in part due to the late 1980s and early '90s, thanks to a combination of changing tax laws and a real estate downturn. A major complaint among investors in those partnerships was their inability to get out once they started mounting. Phillip Cook, a partner in Torrance, Calif., sold limited partnerships 20 years ago, an experience he re-lives with deep regret. One reason he avoided unlisted REITs "like the plague" is their lack of liquidity.

STRATEGY

ABOUT overall returns? They're not certain than those on a publicly traded stock. For one thing, dividend yields are attractive, but they're not guaranteed. More than 117,000 investors, for instance, have already pooled their cash in the Wells Fargo REIT created in 1998. But its dividend was cut 7% from 7.75% in September, 2003.

The overall return of a REIT depends on the success of the strategy, such as an investment. So far, the track record is good. For instance, W.P. Carey has raised 11 of its funds since 1991, providing investors with an average annual total return of 14.1%. Inland took Inland Real Estate public in 2004, at 10 a share. The fund started at \$14, but most investors invested at \$13. They earned an average dividend

of 9% a year from 1998 through the end of the year. The shares trade at \$15.40, with a 24% dividend. Still, a concern in many quarters of the commercial real estate market is that unlisted REIT companies currently are paying top dollar for properties, and these high prices cut into gains when they attempt to return money to shareholders. The strategy of converting into commercial real estate is a popular strategy for many investors. But it's an alternative to untraded REITs ex-

ists: public ones. Over the past five years (ended Dec. 31), they had an average annual total return of 19.1%, vs. 2.7% for the Standard & Poor's 500-stock index. Of course, there's no assurance that the sector will remain hot, but if the public market tanks, so will the private. At least with public REITs, investors can cash out with a click of the mouse.

A Capital-Gains Gambit

BY PETER COY

YOU'RE IN A PANIC. YOU SOLD some commercial property for a few million bucks, and you're facing a big capital-gains tax bill. You can avoid the bite—or defer it, to be exact—if you roll over the money into another property. But the law requires you to pick out the replacement asset within 45 days and close on it within 180 days. The clock is ticking.

In this time crunch, a solution for many investors may be a form of ownership derived from English common law

called a tenancy in common, or TIC. A TIC allows up to 35 investors to jointly own real estate such as an office building, shopping center, or apartment complex. Unlike a real estate investment trust or a limited partnership, a TIC is structured so that participants are direct owners of real estate, allowing them to qualify for a tax-free "like-kind" exchange under Internal Revenue Service section 1031. If you stick with like-kind properties until

your death, your heirs will avoid much if not all of the capital-gains tax.

TICs let investors get a piece of expensive, high-quality properties with credit-worthy tenants that would otherwise be out of their reach. Most properties that are TIC-ified cost \$30 million or more. Last year Santa Ana (Calif.)-based Triple Net Properties, the biggest TIC sponsor, bought a 30-story office building in downtown Chicago for \$174 million.

TICs have grown from almost nothing since a 2002 statement by the IRS clarified their status. Last year TIC sponsors sold \$7.3 billion worth of properties to investors, according to Omni Brokerage of Salt Lake City.

Look out, though. Property prices can be high because some buyers, in their rush to beat the IRS deadline and preserve their capital gains, don't shop around. And TIC sponsors, eager to acquire properties to resell, can spend too much for assets. "There are certainly some TIC sponsors out there who are very good and very responsible, but there's also some massive amounts of overpaying," says Brian Ward, chief executive of Orion Residential, a multifamily housing buyer in Seattle, who says he has been outbid by TIC sponsors on several deals.

The risk, of course, is that the building eventually will be sold for less than the mortgage, wiping out your equity. Some established players are concerned: "The number of sponsors who have popped up because they have dollar signs in their eyes, but they don't have a lot of experience...that scares me," says Patricia Del-Rosso, president of Inland Real Estate Exchange in Oakbrook, Ill., and president-elect of the Tenant-in-Common Assn., a trade organization.

PREMIUM PRICE

FEEES AREN'T CHEAP. In a typical deal, sponsors charge a property-acquisition fee of 2% to 6% of the equity they put into the deal. Sales commissions are 5% to 8% of equity collected, and there can be a 2% to 3% fee for organization and marketing expenses, not to mention the ordinary annual property management fees, which run from 2% to 6% of net rental income.

The governance of these investment vehicles is clumsy. Decisions on such matters as selecting major tenants require unanimous votes. The only solution to an impasse is for one side to buy out the other. And it can be hard to find a qualified buyer if you need to sell your interest.

Most TICs are open only to "accredited" investors, which generally means those who have \$1 million or more in net wealth or annual income of \$200,000 or more for the past two years. Investors who aren't doing a 1031 exchange should think doubly hard about whether a TIC is right for them, because they're paying a premium for a 1031-qualifying property but won't be able to use the tax break.

The best advice is to plan so you're not rushed into a TIC to beat the IRS deadline. A TIC can be a good choice. Just be sure you know what makes it tick. ■

A Checklist

It's easy to go astray when putting money into an untraded real estate investment trust or a tenant-in-common deal. Ask the salesperson:

- What are the fees?
- What is the sponsor's track record?
- Who makes the big decisions?
- How can I get my money out?

Data: BusinessWeek

Candy's Getting Dandier

Now the big companies are offering premium chocolates. Are they worth it? **BY LAUREN YOUNG**



PRICEY JOSEPH SCHMIDT

OPEN UP A HEART-shaped box of chocolates from ethel's chocolate, and you'll find some surprises. The unusual flavors include

Key Lime Limbo, which combines dark chocolate and key lime juice, and Cinna-Swirl, a tangy cinnamon-infused ganache. The chocolates are visually stunning, too: A deep-red piece of Passion Rumba (filled with passion fruit ganache) resembles a ruby.

The biggest surprise, though, is that ethel's isn't a small artisanal candy company. It's the new premium line from McLean (Va.)-based Mars, maker of Snickers and M&M's. Other mass-market companies have introduced upscale lines in the past few months. That's why, in advance of Valentine's Day, we put these new delights to a taste test. Our 12 testers from *BusinessWeek's* staff not only tasted

ethel's but also evaluated the latest premium offerings from Russell Stover Candies, whose candy can be found in drugstores across America; truffles from Joseph Schmidt Confections, an artisanal chocolate maker acquired by Hershey last fall; and Godiva Chocolatier's Platinum Collection, launched in September.

The winner was ethel's, at \$25 for a 6.9-ounce box (20 pieces). While ethel's has a motto of "No mystery middles," some of the funkier flavors such as peanut butter and jelly didn't go over well. But the unique choices as well as the chocolate's silky, smooth taste are what ultimately won the crowd over. "These are the best-looking and the best-tasting," one reviewer said. Another appreciated the small size of the pieces: "You can taste it without going overboard."

Although we had only a photo of the Valentine's Day packaging, our reviewers deemed the pink satin box and brown rib-



RICH GODIVA SATISFIES

bon "hip." Available online at ethelschocolate.com, you can also find candy at department stores such as Neiman Marcus, Macy's, and Marshall Field's. Ethel's has a chain of chocolate lounges in Chicago and is planning to expand the store to other cities.

The runner-up was Godiva, which is \$25 for a 6.25-ounce box (16 pieces). Most reviewers were satisfied with the "rich, creamy" texture of the chocolates. Favorites included

Q&A

Like Wine, Like Chocolate

Chocophile Clay Gordon wants you to appreciate chocolate the same way you would a fine wine. For seven years, the Larchmont (N.Y.) resident has been giving seminars on how to distinguish among the multitude of flavors in chocolate. He worked in computer graphics before a 1994 business trip to Cannes sparked an interest in gourmet chocolate (chocophile.com). BusinessWeek Staff Editor Elizabeth Woyke recently spoke with him about some of the finer points of chocolate.

Do people approach chocolate differently than they approach wine?

Yes. Wine and even vinegar and olive oil are analyzed with an adult palate. But most people have been eating chocolate since childhood. Their taste preferences are often set early on by special memories they have. For instance, Hershey's milk chocolate has a sour-milk flavor. A lot of its popularity comes from its association with childhood.

What do you analyze during your chocolate tastings?

There's the texture: Is it creamy, crumbly, or dry? The smell can be vanilla-y, or resemble [the scent of a] sharpened pencil. The taste can be fruity, nutty, roasty, caramel-like, or hints of licorice. We also consider how the chocolate melts in your mouth and how the flavor stays in your mouth.

What chocolates do you like?

I like chocolate that engages all the senses...that has a "rustic" refined texture. Bonnat's Henri's is a good example. Fel-

(TOP) PHOTOGRAPHS BY MONICA STEVENSON PHOTOGRAPHY; (BOTTOM) PHOTOGRAPH BY ALLISON LEACH



ETHEL'S: TASTE-TEST WINNER

expensive-sounding names such as "Orne," which is filled with a 72% cocoa-anache, and "Orangelide," dark chocolate with a tangy orange filling. But reviewers griped about the sweetness of Godiva's fillings, which include cherry and spicy ginger. And while the (godiva.com) boxes usually look understated and elegant, everyone agreed that the new silver box adorned with a pink ribbon wasn't too special. The testers had no problem identifying Stover's new Private Reserve line, which had a familiar sugary taste and wa-

tery fillings. We liked the solid chocolates best, especially those made with flavorful 70% cacao dark chocolate. The chocolate-covered butterscotch creams and caramels seemed pleasant "but nothing special," one tester said.

A box of Private Reserve, available at major retailers such as Wal-Mart and CVS, costs double the price of the Russell Stover mass-market brand (russellstover.com). That's because the candy is made with high-quality Swiss Callebaut chocolate using a special molding process. Even so, at around \$9 for 8 ounces (16 pieces), everyone agreed with one tester's comment: "These are great for kids on an allowance who want to buy something for their mom."

The priciest box in the bunch, at \$33 for 7.5 ounces (12 pieces), came from Joseph Schmidt. The "sexy-looking"

truffles certainly caught everyone's eye: Cream-colored mounds with a brown dot in the middle looked very provocative. Some testers were overwhelmed by the huge size and gooeyness of each piece. When it comes to rich chocolate confections, dainty is often better. ■

BusinessWeek weekend To see a taste test of many of the chocolates featured here, watch our weekly TV show, *BusinessWeek Weekend* (check your local listings), or watch it on your PC by going to businessweekweekend.com



made from beans harvested in a great new flavor. It's light and citrus-y without all of the aromas in the mouth and in the so like many milk chocolates, especially those with cocoa content above]. They come of the intense, good semisweet or chocolate with creaminess.

How do you rate familiar market chocolate like Cadbury, Russell



GORDON Good taste

Stover, and Whitman's tends to be overpoweringly sweet with primary flavors of caramel or artificial vanilla. They are designed to have a long shelf life, so milk gets replaced with other ingredients and sugar gets added in part because it is a preservative. Ferrero Rocher, Perugina, and Godiva are really better known for their confections (the fillings) than their chocolate bars. Scharffen Berger, acquired by Hershey in July, makes chocolate with a strong red fruit flavor, like plums or cherries.

ONE GIANT LEAP.



EDITED BY TODDI GUTNER

BANKING

TIME OFF

MARDI GRAS WITH A TEXAS TWANG

IT'S NOT THE BIG EASY. But if you're put off by the obstacles to celebrating Mardi Gras in post-Katrina New Orleans, why not let the good times roll in Texas? Mardi Gras! Galveston, which dates back to 1867 and runs this year from Feb. 17-28, expects to draw more than a



half-million revelers. It will salute the Gulf Coast in the wake of the past year's two hurricanes. Besides live music, parades, and masked balls, Galveston is hosting such New Orleans headliners as Dr. John and the Bards of Bohemia. Day tickets are \$10 and \$15; weekend passes, \$25 (mardigrasgalveston.com).

—Monica Gagnier

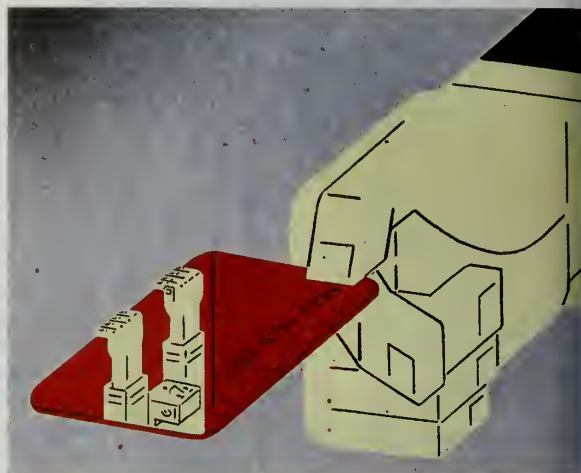
The Debit Shuffle

SWIPE YOUR DEBIT

card at the supermarket, and the cash instantly comes out of your checking account, right? Well, that's what some banks would have us believe. "The money from your purchases comes directly out of your checking account at the time you spend it," Bank of America says on its Web site.

But three Superior Court lawsuits pending in California against BofA, Wells Fargo, and Citibank charge that it isn't so. Many banks hold all transactions until the end of the day, then process them in order of highest to lowest charges. When it happens, you might incur more fees than you would have if funds were debited in the order that the charges were made, says Elaine Kusel, the Milberg Weiss Be & Schuman partner in charge of the case. How? Say you had four small debits the final one of the day was a biggie that exceeded your balance. If the bank paid the big one first, instead of getting hit with just one penalty for insufficient funds, you might have to pay four or five fees of about \$35 each. Banks have long reordered transactions to pay the highest check first because it often was the most important expense—a rent or mortgage payment, for example—according to the American Bankers Assn. Bank of America and Wells Fargo had no comment. Citibank said its suit is without merit.

To avoid such charges, ask how your bank accounts for your debit card purchases. And log your transactions in your checking account ledger.



INVESTING

FULL-SERVICE BROKERS are coming back into favor with people who have at least \$500,000 in investable assets, according to Spectrem Group's recently released Affluent Study of 1,014 investors done in 2005. Some 31% of those polled say they use brokers, up from 24% in 2004. That figure is still down,

	2002	2003	2004	2005
Full-Service Broker	45%*	36%*	24%*	31%*
Investment Adviser	9	14	18	17
Financial Planner	21	23	17	14
Investment Manager	5	5	9	10
Accountant	5	8	9	9
Discount/Online Broker	n/a	n/a	3	7
Trust Officer	n/a	n/a	2	2
Private Banker	1	3	3	1
Other	14	11	15	9

*Respondents using service

Data: Spectrem Group Affluent Study 2005

however, from 45% who used them in 2002. Discount and online brokers also made gains with this crowd in '05, more than doubling their share, to 7%.

GADGETS

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MOST SOLAR CHARGERS work by storing energy from the sun in an internal battery and then using that battery to recharge your cell phone or iPod. Soldius1 skips the intermediate step of recharging your gizmo directly from the sun. You can recharge a phone in three hours, about as long as it takes using a wall outlet. With adapters for the various iPods, it costs \$100 at mysoldius.com.

—Larry Armstrong





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02 / 06



BY GENE G. MARCIAL

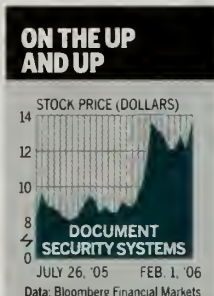
CODED PAPER FROM DOCUMENT SECURITY CAN FOIL CROOKS.

RENOVIS' CEROVIVE MAY BE A BLOCKBUSTER FOR STROKES.

A NEW CANCER TREATMENT IS COMING FROM YM BIOSCIENCES

Watch It, Counterfeiters

COUNTERFEITING is a worry not only with banknotes and documents but also with products such as airplane parts. And a beneficiary in the fight against such crime is Document Security Systems (DMC), whose shares shot up from 8 in September to 13.53 on Feb. 1. This tiny outfit owns patented technology that could be "one of the best solutions to the growing problem," says Otis Bradley of Gilford Securities. Boeing, for example, stamps its components with Document forms that certify their authenticity. Bradley figures sales could triple, to \$6 million, in 2006. In 2007, he sees Document making money on sales of \$10 million. "We expect to get other industries—from pharmaceuticals to carmakers—using our products," says CEO Patrick White. The company has developed "security paper" that, he says, can't be copied or scanned without revealing warning codes on the copies. Boise Cascade sells the paper in North America, while Australia's PaperlinX, the world's largest paper distributor, will market it elsewhere. For packages, Document has the technology to embed hidden authentication words, images, or bar codes that can be detected by handheld readers. White is in talks with General Motors and Bacardi, among others, for possible contracts. Robert Girards of Ergonomics Group, which owns a 5% stake, says the stock is greatly undervalued.



Apoplexy: Renovis Takes Aim

RENOVIS (RNVS), a young biopharma developing treatments for pain, trauma, and stroke, could be joining the big leagues. It has teamed up with AstraZeneca for a potential blockbuster, Cerovive, an intravenous compound for acute ischemic stroke now in clinical trials. Also, in July it received \$10 million from Pfizer in up-front licensing fees and \$900,000 in research funds for drugs to treat pain, inflammation, and other ills. It could get an additional \$170 million in progress payments, plus royalties. Although Renovis stock leaped from 12 in August to 20.97 on Feb. 1, it "merits greater investor attention," says Mark Monane of Needham, because of initial results from Phase III trials of Cerovive. That prompted AstraZeneca to apply to sell

it as a new drug in the first half of 2007, rather than later. Additional favorable results, he says, are expected from Cerovive's current tests. Monane rates the stock a buy, with a 12-month target of 26. Mark Basham of Standard & Poor's, even more bullish, calls it a "strong buy" with a target of 30. Complete success of Cerovive, he says, might mean multibillion-dollar annual sales. If that happens, some say AstraZeneca might just opt to buy Renovis.



YM Biosciences' Cancer Drugs Are Working

ANOTHER TINY BIOTECH, YM Biosciences (YMI), trading on the Amex, may also have a winner: Tesmilifene for metastatic breast cancer. Now in Phase III, Tesmilifene has been shown to improve the effectiveness of commonly used chemotherapies in prolonging life. In January, YM signed a pact with Sanofi-Aventis to investigate the effectiveness of combining Tesmilifene with Sanofi's Docetaxel to treat fast-growing tumors. The study will test whether using Tesmilifene together with Docetaxel enhances the survival of seriously ill patients without increasing toxicity. Initial research will be conducted in Europe and the U.S. Another YM product, for brain cancer, will go into Phase III trials soon. Mitchell Kaye of XmarkCapital Partners, the lead investor, with 10%, says Tesmilifene could generate annual sales of \$1 billion. Now at 3.53 a share, YM could hit 15 in a year, Kaye figures. He also expects good results from trials of YM's AeroLef, an inhaler that provides quick pain relief to cancer victims, posted soon. Maher Yaghi of Desjardins Securities, who rates YM a buy, sees it making money in 2009 on projected sales of \$36 million, and \$43 million in 2010. ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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Personal Business Figures of the Week

STOCKS



COMMENTARY

Stocks advanced in the face of yet another Fed rate hike. Record earnings from Exxon and strong forecasts from Honeywell and Caterpillar sent the Dow and S&P 500-stock indexes up 2.3% and 1.4%. The NASDAQ Composite added 2.2%, especially impressive given the sharp drop in Google shares on Feb. 1 after the search giant's earnings disappointed investors.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	FEB. 1	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1282.5	1.4	2.7	7.8
Dow Jones Industrials	10,954.0	2.3	2.2	3.8
NASDAQ Composite	2310.6	2.2	4.8	11.7
S&P MidCap 400	781.9	2.5	5.9	20.1
S&P SmallCap 600	380.0	2.7	8.4	17.3
DJ Wilshire 5000	12,944.8	1.5	3.6	10.6

SECTORS

	FEB. 1	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	770.0	1.6	3.8	10.2
BW Info Tech 100**	391.9	1.7	3.0	9.4
S&P/BARRA Growth	610.9	1.3	2.4	6.9
S&P/BARRA Value	667.5	1.5	3.1	8.8
S&P Energy	416.3	1.6	11.7	37.5
S&P Financials	429.4	1.1	0.7	5.7
S&P REIT	165.0	2.0	7.8	24.3
S&P Transportation	256.7	0.0	2.7	15.6
S&P Utilities	163.8	-0.6	2.6	12.6
GST Internet	207.6	0.2	1.2	24.9
PSE Technology	881.1	2.4	5.3	18.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	FEB. 1	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1613.5	2.2	6.7
London (FT-SE 100)	5801.6	1.7	3.3
Paris (CAC 40)	4999.4	4.3	6.0
Frankfurt (DAX)	5726.5	5.5	5.9
Tokyo (NIKKEI 225)	16,480.1	5.3	2.3
Hong Kong (Hang Seng)	15,742.3	1.4	5.8
Toronto (S&P/TSX Composite)	11952.1	2.4	6.0
Mexico City (IPC)	19162.4	1.6	7.6

FUNDAMENTALS

	JAN. 31	WEEK AGO
S&P 500 Dividend Yield	1.77%	1.79%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.1	18.2
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	14.8
First Call Earnings Surprise*	3.29%	3.81%

TECHNICAL INDICATORS

	JAN. 31	WEEK AGO
S&P 500 200-day average	1221.4	1218.1
Stocks above 200-day average	68.0%	67.0%
Options: Put/call ratio	0.66	0.75
Insiders: Vickers NYSE Sell/buy ratio	3.84	3.88

BEST-PERFORMING GROUPS

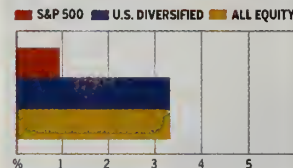
	LAST MONTH %	LAST 12 MONTHS %
Steel	27.8	86.9
Oil & Gas Refining	23.1	77.2
Oil & Gas Extraction	22.4	77.2
Agricultural Products	18.2	69.3
Automobiles	16.2	67.4
Oil & Gas Refining	16.2	67.4

WORST-PERFORMING GROUPS

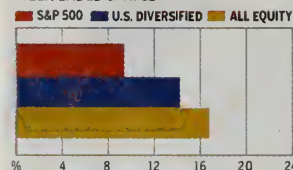
	LAST MONTH %	LAST 12 MONTHS %
Internet Software	-11.8	Automobiles
Tires & Rubber	-8.9	Photographic Product
Educational Services	-7.5	Auto Parts & Equipment
Auto Parts & Equipment	-6.6	IT Consulting
Commercial Printing	-5.7	Brewers

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	13.4	Latin America	80.8
Precious Metals	12.5	Precious Metals	64.8
Natural Resources	9.5	Natural Resources	56.5
Diversified Emerg. Mkts.	8.9	Diversified Emerg. Mkts.	48.3
LAGGARDS		LAGGARDS	
Financial	0.9	Domestic Hybrid	8.2
Domestic Hybrid	1.3	Large-cap Blend	10.2
Large-cap Value	1.5	Miscellaneous	10.4
Japan	1.5	Financial	10.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Precs. Mtis. Inv.	18.9	ProFunds Ult. Japan Inv.	105.7
iShares MSCI Brazil Idx.	18.9	ProFunds Precs. Mtis. Inv.	103.1
U.S. Gl. Invs. Prec. Mnls.	17.3	iShares MSCI Brazil Idx.	93.6
U.S. Global Invs. Gold	16.5	T. Rowe Price Latin Am.	89.8
LAGGARDS		LAGGARDS	
Potomac Sm. Cap/Sh. Inv.	-12.9	Ameritor Investment	-63.2
ProFds. USh. Sm. Cap Inv.	-12.8	American Heritage Grth.	-42.9
ProFds. Sh. Oil & Gas Inv.	-8.3	ProFds. USh. Mid Cap Inv.	-30.3
ProFds. USh. Mid Cap Inv.	-7.7	ProFds. USh. Sm. Cap Inv.	-28.5

INTEREST RATES

KEY RATES

	FEB. 1	WEEK AGO
Money Market Funds	3.94%	3.88%
90-Day Treasury Bills	4.47	4.42
2-Year Treasury Notes	4.58	4.46
10-Year Treasury Notes	4.56	4.48
30-Year Treasury Bonds	4.71	4.66
30-Year Fixed Mortgage†	6.14	5.90

†BancC

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR BONO	30
General Obligations	3.82%	
Taxable Equivalent	5.46	
Insured Revenue Bonds	3.91	
Taxable Equivalent	5.59	

THE WEEK AHEAD

INSTALLMENT CREDIT Tuesday, Feb. 7, 3 p.m. EST »

Consumers are forecast to have accumulated \$4.9 billion of additional debt during the month of December. That's according to the median forecast of economists surveyed by Action Economics. In November the outstanding amount of consumer credit shrank by \$0.6 billion. The slight slowdown in car sales along with deep discounts are set to cause the

smallest annual increase in non-revolving credit since 1997.

INTERNATIONAL TRADE Friday, Feb. 10, 8:30 a.m. EST » The foreign trade deficit most likely posted a slightly smaller deficit of \$63.5 billion during December. Lower crude oil and natural gas prices, along with a rebound in exports, especially in civilian aircraft, caused the November trade gap to narrow to \$64.2 billion.

FEDERAL BUDGET Friday, Feb. 10, 2 p.m. EST »

The federal government probably rang up a \$12 billion surplus in January, after an \$11 billion surplus in December. If the January report is also positive, it would mark the first back-to-back monthly surpluses since January, 2003. There is some uncertainty due to the size and timing of outlays for hurricane victims along the Gulf Coast region and Florida.

The BusinessWeek product slipped to 270.1 for the week Jan. 21, but it stood 12.2% a year-ago reading. Before the end of the four-week moving average index rose to 270.4.

BusinessWeek 0

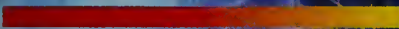
For the BW50, more investment data, and the component of the production index visit www.businessweek.com/magazine

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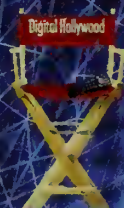
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of the spots that get talked
about as much as the game.

Killer PDAs: With the fate of
Blackberry in legal limbo, we
review the newest generation
PDAs that do it all.

Investing in retail: As Fashion
Week takes stage in New York,
we look at which retail and
apparel stocks make the cut.

Sweet rewards: Just in time
for Valentine's Day, we taste
test premium chocolates.

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Outrage Deferred

CONFESSIONS OF A WALL STREET ANALYST A True Story of Inside Information and Corruption in the Stock Market

By Dan Reingold with Jennifer Reingold; Collins; 348pp; \$25.95

Telecom's spectacular multitrillion-dollar boom and bust seem like ancient history. Once almighty WorldCom, its remnants snapped up by Verizon Communications and its founder headed to jail, is no more. Ditto for scores of upstart 1990s carriers. As for the Wall Street analysts who egged on the telecom train wreck, the ones who

haven't been downsized or permanently barred from the industry don't have much left to analyze.

And yet six years later, the excesses of that time retain enough pungency for a Wall Street tell-all. Dan Reingold, a former top-ranked telecom analyst who left Credit Suisse First Boston LLC in 2003, delivers just that in *Confessions of a Wall Street Analyst: A True Story of Inside Information and Corruption in the Stock Market*. As he explains in his prologue: "Many of the worst transgressions...went unpunished and uncorrected. Hence this book." The cover promises: "What Eliot Spitzer Never Told You." But while Reingold, co-writing with his niece, *Fast Company* writer and *BusinessWeek* alum Jennifer Reingold, tramples over his Street confidentiality agreements to share sordid, often appalling anecdotes from the telco bacchanal, *Confessions* sadly arrives far too late to qualify as meaningful whistle-blowing.

In 1989, Reingold was recruited to genteel Morgan Stanley from his investor-relations job at scrappy MCI. Although at MCI he was immersed in the art of finessing earnings guidance, with all the winking and body language that entailed, he says he made the leap to Wall Street intending simply to "write reports from the quiet of an office overlooking Midtown Manhattan as competently as any telecom analyst out there." Future über-analyst Jack Grubman, then a rising telecom researcher at Paine Webber, predicted to a colleague that Reingold wouldn't make it. The two would become archrivals over the following decade.

The booming 1990s—the decade of privatization, deregulation, and the explosive growth of the Internet—made it nearly impossible for a telecom analyst to avoid the limelight. With billions of dollars in banking fees at play, a guy like Reingold became a hot commodity worthy of headhunting and huge pay packages, first at Merrill Lynch & Co. and then at CSFB.

The ensuing workaholicism inevitably took its toll. In 1991, while at the hospital where his mother was having surgery for a brain tumor, Reingold scrambled to file reports from a room full of pay phones when news broke that WorldCom was buying MCI. "Yes, my priorities were out of order," he writes, "but that was what Wall Street was all about, wasn't it?"

But Reingold claims he kept his sense of outrage about the increasingly unabashed conflicts of interest between investment banking and research, the kind that Grubman (and his \$25 million pay package at Salomon Smith Barney) openly espoused. As evidence, Reingold points to his refusal to let Merrill bankers pressure him to sign off on lucrative

IPOs of carriers with suspect business models. At CSFB, he turned down an incentive arrangement wherein he would have answered directly to the bankers. On the other hand, Reingold argues, Grubman tailored his research to the demands of the underwriting calendar. Most infamously, he went bullish on AT&T ahead of the carrier's record \$10.6 billion wireless initial public offering in April, 2000 (partly as a quid pro quo for his children's nursery school admission). Reingold also contends that Grubman was using his privileged connection to management and bankers to deliver impending merger information to clients. "Grubman's research is a sham," Reingold warned an executive. "In effect, he's a whore

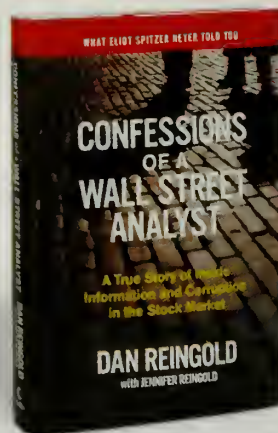
and everyone knows it." Grubman did not return Reingold's phone calls.

And yet Reingold kept his mouth shut. "The Street's code of silence...all you could do was sit back and watch," he writes of Grubman's unethical rise to the top. In fact, had Reingold had the courage of his conviction, he would have quit his job or blown the whistle when the time so would have mattered. Instead, he waited until

2003, to finally step down from his multimillion-dollar job at CSFB.

Confessions correctly argues that half-baked regulation not put an end to rampant insider trading and compromised Wall Street research, indignantly noting that the biggest hucksters from the telecom bubble returned only a fraction of their ill-gotten gains. Still, coming in 2006, its value lies mainly in a colorful portrayal of egos, salary negotiations, and the daily dispensing of B.S. Had it been published six years ago, the book would have offered so much more. ■

—By Robert



A juicy tell-all about the telecom bacchanal, delivered six years too late

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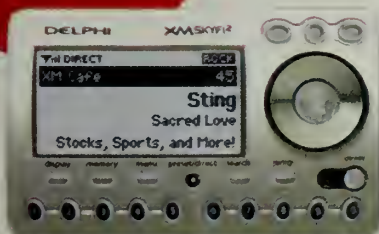
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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

What's Holding Women Back

It's 2006 and there still aren't many women CEOs in America. In some countries, there aren't even that many women executives. Why can't women seem to get ahead in the corporate world?

—Yvonne Beckley Borquez, New Bern, N.C.

The easy answer is that the corporate world is fundamentally sexist, that the men in charge don't want women to succeed and conspire to deny them promotions, underpay them, or both. This is basically the "Men are Neanderthals" explanation, and sadly, in some countries and companies, it's the status quo. Mainly because of culture or ingrained biases, there are men who think women don't belong in corporate settings, and they band together to create work environments where women can't move up even if they try like crazy. Usually this male resistance is subtle and surreptitious. Sometimes men don't even realize they are doing it. Regardless, women pay the price.

There is a second answer that isn't so easy. We say that because every time we mention it in speeches, the audience groans with discomfort. That answer is "biology." There are few women CEOs and a disproportionately small number of women senior executives because women have babies. And despite what some earnest but misguided social pundits might tell you, that matters. Because when professional women decide to have children, they often also cut back their hours at work or travel less. Some women change jobs entirely, taking staff positions with more flexibility but much lower visibility. Still more women leave the workforce entirely. A 2002 Harvard Business School survey of alumnae from the classes of 1981, 1986, and 1991 found that 62% had left the professional world. That's right, out of all those women graduates who immediately went on to jobs in consulting, finance, and line management, only 38% were still working full-time.

The choice to have children is completely personal, but like any other life-changing event, it has career ramifications. Most notably, it tends to slow down advancement.

Is that bad? We don't think so. It's life. Every choice has a consequence. As a working mother you gain something of immeasurable value: more time with your children. You also give up something: a spot on the fast track. In business, where

bosses are paid to win and shareholders are watching, top slots don't go to people who aren't available.

But, you may ask, doesn't talent matter? The answer is yes. And talent is often the saving grace for women who want families *and* a vibrant career. If you're a working mother consistently delivers dynamic results, most bosses will give you the flexibility you want. But you have to earn it. That takes time. Maybe years. Often, though, women can't or won't wait that long to be mothers. So they drop out, shrinking the pool of promotable women and contributing yet another reason why fewer women advance.

Many good companies have made enormous strides in helping women keep their careers on track while their children are young by forging creative part-time solutions. But as long as professional advancement is based to a considerable degree on availability, commitment, and consistent performance, and as long as mothers want to spend time with their children, women's careers will always have a different, more circuitous path than those of men.

I have an ethical dilemma. I'm an in-house consultant at a manufacturing company. However, I have noticed that corporate executives do not find my work useful or important. Should I leave or stay, knowing that my work might never be recognized?

—Anonymous, São Paulo

You don't have an ethical problem. You have a classic career problem, and the solution is straightforward: You need to be valued. Look, you're at a company where the work you do is valued. It doesn't make any difference if you are right or wrong. Your work could unlock untold profits. But if your bosses fundamentally don't think it matters, you will be shouting into the wind forever.

Your problem is "classic," incidentally, because it's so common. It typically starts with the creeping sense that the terrific work you're doing doesn't interest the powers that be. The situation quickly spirals downward. The employee becomes angry and frustrated, the bosses grow annoyed, the disconnect widens, employee performance usually worsens, and resentment on both sides builds.

Then boom! The employee is canned or quits in a rare lucky break. Luckily, it is not too late for you. Make your exit amicable and orderly. That will be good for both the company and your reputation. But do what you need to do soon: Move on.

*Jack and Suzy Welch are co-authors of the best-seller **Winning** (HarperCollins, 2005). They look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com.*

As women drop out, the pool of candidates for top jobs shrinks further



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Ideas Outside Shot

BY MARISSA ANN MAYER

Creativity Loves Constraints

When people think about creativity, they think about artistic work—unbridled, unguided effort that leads to beautiful effect. But if you look deeper, you'll find that some of the most inspiring art forms, such as haikus, sonatas, and religious paintings, are fraught with constraints. They are beautiful because creativity triumphed over the "rules." Constraints

shape and focus problems and provide clear challenges to overcome. Creativity thrives best when constrained.

But constraints must be balanced with a healthy disregard for the impossible. Too many curbs can lead to pessimism and despair. Disregarding the bounds of what we know or accept gives rise to ideas that are non-obvious, unconventional, or unexplored. The creativity realized in this balance between constraint and disregard for the impossible is fueled by passion and leads to revolutionary change.

A few years ago, I met Paul Beckett, a talented designer who makes sculptural clocks. When I asked him why not do just sculptures, Paul said he liked the challenge of making something artistically beautiful that also had to perform as a clock. Framing the task in that way freed his creative force. Paul reflected that he also found it easier to paint on a canvas that had a mark on it rather than starting with one that was entirely clean and white. This resonated with me. It is often easier to direct your energy when you start with constrained challenges (a sculpture that must be a clock) or constrained possibilities (a canvas that is marked).

As vice-president for search products and user experience at Google, I lead a team whose job is to harness and meld the creative forces of engineers and to channel that creativity into making something that people can use. In product development, we see many different types of constraints. Sometimes they can be the conditions by which the problem must be solved. At Google, the products and services we deliver have to work well for all kinds of users.

Consider, for example, our recent release of the new Google Toolbar beta. When we develop a toolbar version, we can't contemplate only what functions would be useful or which features users ask for most. We also must think about how to create a toolbar that works for all users regardless of whether their screen resolutions allow for five buttons across or 35. We need to make sure that it is fast to download, even over a modem. The new Toolbar has a lot of novel functions, but it is also restricted in download size to just 625 kilobytes, and it allows users to customize how

many and which buttons they want to include.

Constraints can actually speed development. For instance, we often can get a sense of just how good a new concept is if we only prototype for a single day or week. Or we'll keep team size to three people or fewer. By limiting how long we work on something or how many people work on it, we limit our investment. In the case of the Toolbar beta, several features (custom buttons, shared bookmarks) were tried out in under a week. In fact, during the brainstorming process, we came up with about five times as many "key features." Most were discarded after a week of prototyping. Since then, 1 in every 5 to 10 ideas works out, the strategy of limiting

time we have to prove that an idea works allows us to try out more ideas, increasing our odds of success.

Speed also lets you fail faster. Have you ever wondered how a product so lame got to market, a movie so bad got released, or a government policy so misguided got passed? In cases like these, it's likely that the people working on the project invested so much time that it was painful to walk away. They often know the endeavor is misguided, yet they work till the end, a painful, unsuccessful end. That's why it's important to discover failure fast and abandon it quickly. A limited investment makes it easier to move on to something else that has a better chance of success.

Yet constraints alone can stifle and kill creativity. While we need them to spur passion and insight, we also need a healthy dose of hopefulness to keep us engaged and unwavering in our search for the right idea. Innovation is born from the interaction between constraint and vision.

Henry Ford once said: "If I'd listened to customers, I never would have given them a faster horse." True creativity makes impossible possible. It can revolutionize a product, a business, the economy, and the world around us. ■

Marissa Ann Mayer is vice-president for search products and user experience at Google. She holds an MS in computer science from Stanford University and joined Google in 1999.

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CAN MTV STAY COOL?

How CEO
Judy McGrath
must remake her
TV empire for
a digital world

BY TOM LOWRY (P.50)

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Or will you be forced
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My first victim was a doll named Tabitha. She was the most fashionable, one-armed, hair-made-of-yarn girl the town had ever seen. Invited to all the best tea parties. Those days, I tone it down a little. But fabrics are still my thing. I find them in parts of the world I can't even pronounce. And now my creations are worn by people I don't even know. On red carpets all over the world, not to mention all the best tea parties, I'm sure.

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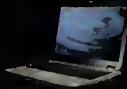
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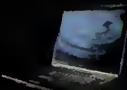
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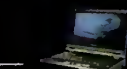
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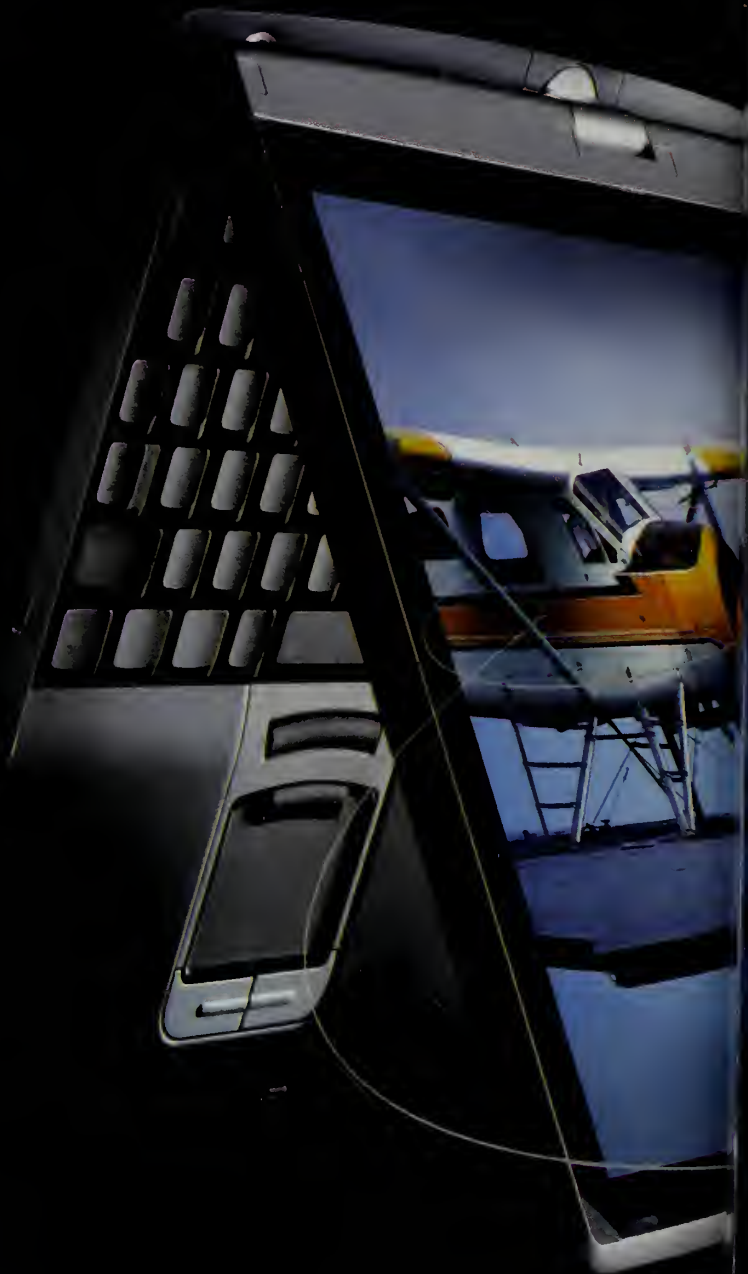


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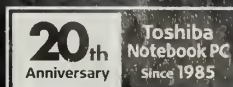
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Cover Story

50 Can MTV Stay Cool?

The kid from Scranton has rock 'n roll dreams. Now Judy McGrath is chairman of MTV, a \$7 billion hub of some of the hottest acts in show biz, from Comedy Central's Jon Stewart to Nickelodeon's SpongeBob. But with business model being reinvented at an ever-quickening pace—especially in media—staying ahead of trends is a challenge even the nimblest networker. And McGrath's MTV must change fast enough to thrive in the Age of iPod.

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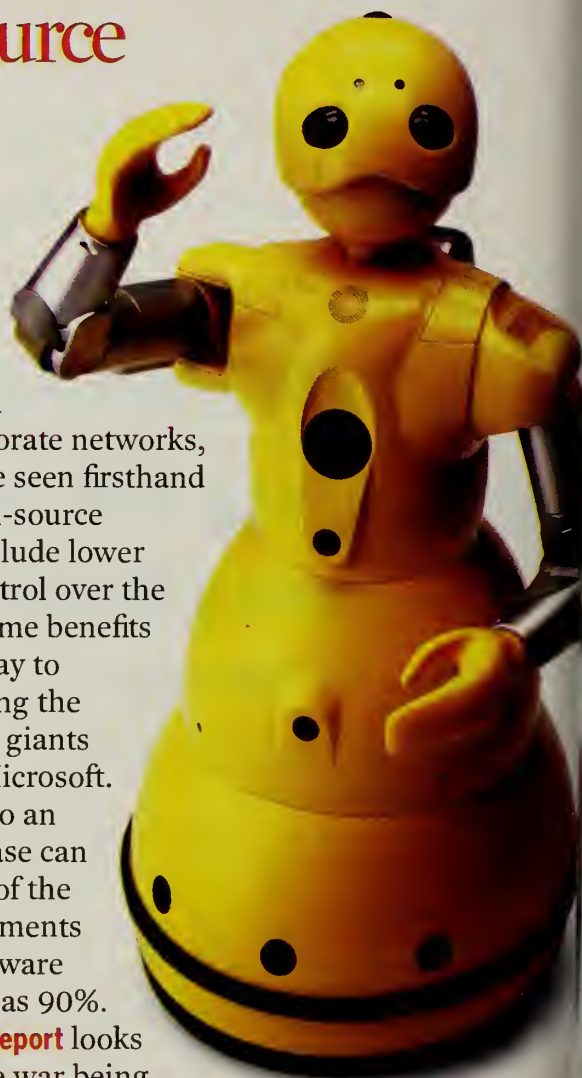
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Open Source Is on the March

Since the Linux operating system started making big inroads with the servers that run

Web sites and corporate networks, big companies have seen firsthand the benefits of open-source software, which include lower costs and more control over the code. Now those same benefits are making their way to **database software**, long the domain of industry giants Oracle, IBM, and Microsoft. Indeed, switching to an open-source database can slash costs for one of the most expensive segments of a company's software budget by as much as 90%.

This **Online Special Report** looks at the new database war being sparked by upstarts out to challenge the big guys in this crucial market. It also examines the increasingly contentious issue of **software patents** and how the open-source movement is both part of the problem and perhaps part of the solution. And in a slide show titled "**Linux Everywhere?**" we show the wide range of places where the free operating system is going to work, from automobiles to robotics. You'll find all this and more at www.businessweek.com/go/06opensource



Mitsubishi's
Wakamaru
has a brain
on Linux

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**"[Jeff Bewkes]
is a terrific piece
of manpower."**

— Frank Biondi on why he'd
like Bewkes to work for him
if Carl Icahn succeeds in
his plan to break up
Time Warner

D BY DAN BEUCKE

STREET NEWS WHISPER NUMBERS CAR AGAIN

WHISPER" NUMBERS are
When Google shares fell
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that was because the
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bt expectations. John
ne, president of estimate
le for **WhisperNumber.com**,



says: "We've heard that story
since 2001, but expectations
never leave the market."

If anything, whisperers
may have gained Street cred.
A study by **San Jose State
University** professors Janis
Zaima and Maretio Harjoto
finds the market relies more
on the crowd's wisdom than
on big-brokerage forecasts.
The study found that markets
move modestly when profits

beat or fall short
of Street
estimates, but
really move when
varying from the
whisper. It recom-
mends betting on
whisper numbers
when they differ

from analyst projections.

The next chance to test the
theory? On Feb. 15 whisper-
ers expect **Hewlett-Packard** to
report it earned 50¢ a share
in the fourth quarter—6¢
more than analysts forecast.

—Timothy J. Mullaney

NEXT? Moore
is taking on
the health-
care industry



COMING ATTRACTIONS

Look Out, Dr. Moore Is In

MOVE OVER, GM. Michael Moore has a new corporate
bogeyman. On Feb. 3 the muckraking filmmaker posted a
letter on his Web site headlined "Send me your health-care
horror stories." Moore, who first made waves in 1989 by going
after **General Motors** in *Roger & Me*, is now targeting the \$1.9
trillion health-care industry with an upcoming film called
Sicko. And he wants real-life examples of hospitals, insurance
companies, and drugmakers run amok.

If health-care execs worry that they might be demonized,
Moore's letter leaves little doubt: "...Maybe you've just been
told that your father is going to have to just, well, die because
he can't afford the drugs he needs... and it's then that you say,
'Damn, what did I do with Michael Moore's home number?!'"
Moore says he'll read each letter: "...if you have been abused in
any way by this sick, greedy, grubby system and it has caused
you or your loved ones great sorrow and pain, let me know."
No surprise, drug companies already wish Moore would just
go away. "He has no intention of being fair and balanced,"
says Ken Johnson, senior vice-president of the **Pharmaceutical
Research & Manufacturers of America**.

—Arlene Weintraub

THE BIG PICTURE

ROUGH BREAK Companies
trotted out myriad
anations for falling short on
a quarter's earnings. A sampling
of some of the primary reasons given:



	% CHANGE*	EXPLANATIONS**
Bo	-15	Cost of developing new truck products
Men	-43	Rise in free-shipping incentives, tech investments
and America	-2	Unexpected rise in consumer bankruptcy filings
Health	-55	Hurricane-related costs
Cost	-69	Decline in investment income

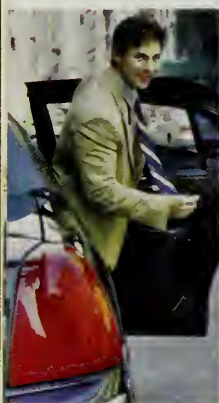
*In fourth-quarter net income vs. year-earlier period
**Include other reasons given by the companies

Data: BusinessWeek, company reports

THE STREET

LOBSTER AND CRISTAL FOR THE INTERN

NOT ALL INTERNS are created equal. While many toil away in corporate mail rooms for little or no compensation,



some finance majors on Wall Street will earn up to \$15,000 this summer. February marks the height of undergraduate recruiting for firms such as **Goldman Sachs** and **Merrill Lynch**, and a few lucky candidates are

getting a decadent taste of what's to come. After multiple interviews at top schools, finalists are flown to

headquarters to mix and mingle with senior managers. The selling involves more than just pizza and bowling. "They're getting wine and dined in New York, staying at the finest hotels, and eating \$400 dinners," says Steven Rothberg, president of **CollegeRecruiter.com**. "It's absurd, but it works."

There's a reason for Wall Street's open-wallet policy. With undergraduates making up 75% of new hires at Merrill, relationship-building is paramount. "If they're not with us, they're with our competitors," says Connie Thanasoulis, Merrill's chief operating officer for campus recruiting. Most companies won't discuss specifics, but Merrill recruiters say they cover all candidates' expenses, including travel, lodging, meals, and sometimes even those of a "significant other." Dude, is it too late to change majors? —*Bremer Leak*

FIT FOR A WAIF

MOST CLOTHING

retailers are adding bigger sizes as people get fatter. But one is moving in the opposite direction: In recent weeks, **Banana Republic** has added—suck in your gut now—a size "double zero" to its women's pants, skirts, and dresses to cater to sylphs who just can't quite fill out a size 0. The chain says a "00" fits a woman with a 31-in. bust, 23-in. waist, and 32-in. hips. The average woman wears a 12, with proportions of 39-34-41. Still, the tiny size may attract a new market for Gap Inc. unit: teen girls, who are more likely to look like Twiggy than its current core of thirtysomething customers. —*Louise*



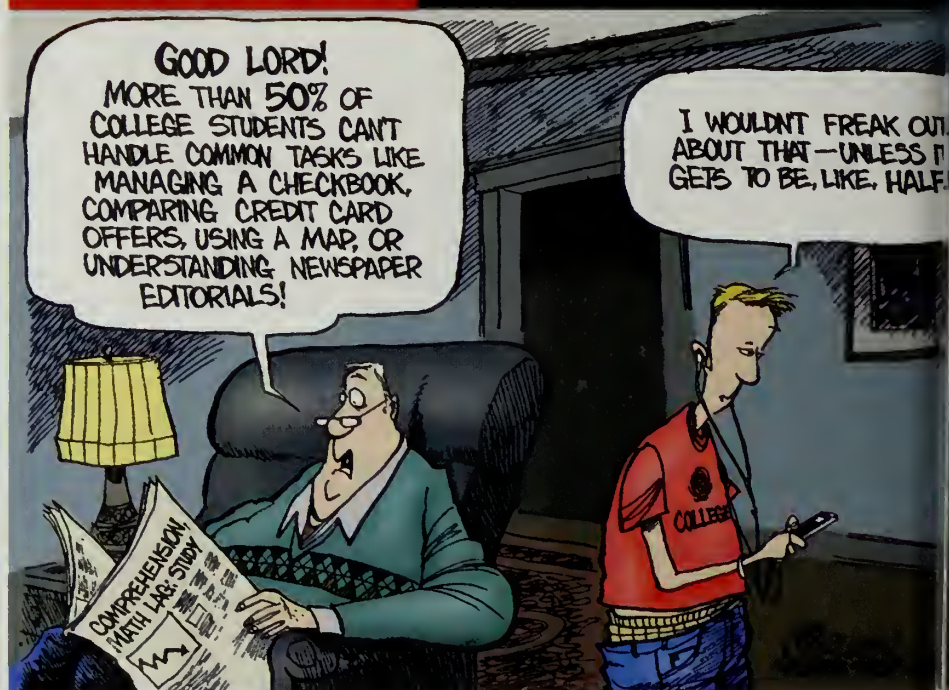
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ROCK ON, SENATORS

The Jack Abramoff scandal may slow the flow of favors from K Street to Capitol Hill. But one activist group is determined to get senators rocking. The Intellectual Property Action Committee (IPAC), which promotes digital copyright standards that help new technologies, is collecting money to buy each senator a video iPod, at \$324.42 apiece (including sales tax).

The move was inspired by Senate Commerce Committee Chairman Ted Stevens (R-Alaska, above). IPAC President David Alpert says the octogenarian has a keen understanding of digital copyright issues thanks to an iPod he got from his daughter: "Having an iPod...lets senators understand the technology that their legislation is going to affect." IPAC says the iPods are contributed as in-kind donations to senators' campaigns, which is legal under current law. The group has received money for 12 so far. —Catherine Yang

BACKLASHES

VIDEO GAMES ARE THE BEST REVENGE

THE OLD ADAGE IS, never pick a fight with someone who buys ink by the barrel. These days, Big Business also is learning not to antagonize video game designers. As Mitsubishi, McDonald's, and FedEx Kinko's found out, they can get nasty and mock your product by making a game of it. Increasingly, the spoofs are popping up on the Web.

Software engineer Shawn McGough says he created *Melting Mitsubishi* after the paint on his new Mitsubishi Lancer wore away just months after purchase. Players must zap raindrops and spinning Mitsubishi logos away from a yellow Lancer before its paint melts off. In an anti-McDonald's game created by *Molleindustria*, an Italian company specializing in games for activists, players



switch back and forth between a McDonald's farm, feedlot, restaurant, and headquarters. Players can boost their score by fattening cows with hormones and firing inefficient workers, hitting on themes familiar to critics of Big Food. If profits dip, an evil-looking Ronald McDonald admonishes: "Shame on you, you bankrupted the company!"

In *Disaffected!* from *Persuasive Games*, players staff a Kinko's counter. Employees have one mode, indifferent, as they grunt,

confuse orders, or refuse to work. The game ends when irate customers exit without paying. More than 50,000 people have downloaded *Disaffected!* since its debut mid-January, says designer Ian Bogost. But it may have an unintended effect. "It made me appreciate what [Kinko's] employees must go through," noted one player on gaming blog *Joystiq.com*. Kinko's says it takes "strong exception" to the characterization. Mitsubishi declined to comment; McDonald's had no response. —Elizabeth W.

REWIND

IS SCRUSHY PLAYING THE RACE CARD AGAIN?

LESS THAN THREE MONTHS before jury selection is to begin in his second federal criminal trial, former HealthSouth CEO Richard Scrushy is asserting his right to an impartial jury. In his eyes, that includes challenging the racial composition of the grand jury that indicted him as well as the panel from which jurors will be selected. Scrushy asked a federal judge on Jan. 24 to let his legal team examine jury records in order to substantiate his claim that central Alabama juries "systematically under-represent African-Americans," according to an affidavit filed with his motion. He is set



to go to trial on May 1 on charges that he bribed former Alabama Governor Donald Siegelman in exchange for influence over a state hospital regulatory body.

Prosecutors are concerned that Scrushy is trying to replicate a strategy that worked in his last trial: He was acquitted on accounting fraud charges last year by a jury of seven blacks and five whites after months of courting local black church congregations and clergy ("Richard Scrushy's 'Amen Corner,'" *Business Week Online*, Jan. 20, 2006). Scrushy asserts through court filings that while counting the Middle District of Alabama are about 30.5% African American, the jury selection process in that district results in a substantially lower share of African Americans. On Feb. 3 the court issued an order granting Scrushy's team access to limited jury records. If he can substantiate his claims, he's expected to renew a request to dismiss the indictment. Scrushy's trial attorney could not be reached for comment. —Coleman C.

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For every job that is outsourced, the Social Security Fund loses thousands...which adds to every citizen's tax bill."

—Thomas G. Baranski
 Memphis

THE UPSIDE AND DOWNSIDE OF OUTSOURCING

RE "THE FUTURE of outsourcing" (Cover Story, Jan. 30): A closer examination of the international data reveals not only that U.S. companies are outsourcing abroad but also that foreign companies are outsourcing to the U.S. at a record rate, thus creating high-paying jobs in the U.S. International data from 2004 reveal that U.S. imports of services amounted to \$296 billion, but the export of U.S. services was \$343 billion—an absolute record—giving the U.S. a balance-of-trade surplus of \$47 billion in services. (Unfortunately, the U.S. has a deficit in manufacturing, in 2005 exporting only \$807 billion and importing \$1.47 trillion.)

Outsourcing highlights the changing structure of the U.S. economy, with about 80% of workers employed in services, about 19% in manufacturing, and only 1% in farming. With more than 100 million U.S. workers now in services, I expect outsourcing to grow at an exponential rate in the next decade, forming a larger share of the U.S. trade balance and giving the U.S. a comparative advantage in services.

—Pellegrino Manfra
 New Rochelle, N.Y.

YOU COULD HAVE mentioned the tax rates that India is moving to against foreign operations but against Indian-owned outsourcing firms. With latecomers following the herd, India's crowded cities, early entrants increasingly looking next door to the opportunities provided by Pakistan's English-speaking talent pool, newer in structure, and low overall risk.

Americans can encourage peace and stability in the region by distributing work between both countries.

—Anthony Mitro
 Seattle

IT'S ABOUT TIME someone in the media highlighted the true upside to outsourcing. The best success stories are yet to come.

I hope Lou Dobbs got hold of that idea.
 —Frank C. ...
 Founder and
 The Outsourcing Institute
 Jericho, N.Y.

INVESTORS MUST VIEW warily companies that are aggressively pursuing outsourcing as described in your article. Such "externally leveraged"

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ReadersReport

disaggregated) businesses have placed their intellectual property and core competencies at great risk, potentially compromised their long-term competitiveness, and unnecessarily exposed themselves to significant macroeconomic risks. Even more significant, these companies have done so based on claims of cost savings and other advantages from service outsourcing that have not been adequately scrutinized and may prove deceptive. None of these risks are accounted for in the stock valuations of these outfits.

The savings of 5% to 10% from successful service outsourcing cited in your story, achieved only after several years of effort, is marginal at best and may be completely eroded by the disruption of operations, loss of key employees (and customers), and ill will generated, none of which is accounted for. Additionally, many service outsourcing projects fail to produce any tangible results at all.

—James Bonang
Garden Grove, Calif.

HAVING SERVED AS the network manager for the ARPANET and having designed and developed networks for the past 40 years, I read “The future of outsourcing” with interest and concern. Outsourcing has an Achilles’ heel that has me troubled about corporations placing key business processes in other political entities.

The risk is based on the growing ability of nation-states to restrict process interconnectivity and data access. A case in point is China’s effort to censor the Internet. If China is successful in controlling the Internet for political purposes, then the next step is commercial. Since U.S. vendors are developing the technology for China, it could be available for any nation to use to control and restrict their knowledge and business processes and also potentially subvert other nations’ data infrastructures.

—Joe Haughney
Lynnfield, Mass.

YOUR ARTICLE MISSES one very important point: For every job that is outsourced, the Social Security Fund loses thousands of dollars, which adds to every citizen’s tax bill. An outsourced job that earns an American worker \$40,000 per year reduces the fund’s income by \$6,000 per year (based on 15% for the worker and employer contribution). The employer is saving about 75% of that \$40,000-a-year eliminated position, its 50% portion of the eliminated contribution to the Social Security Fund of \$3,000, plus a big health-care cost as

CORRECTIONS & CLARIFICATIONS

In “The future of outsourcing” (Special Report, Jan. 30), the table accompanying “Hot players in the offshore outsourcing world,” the No. 10 entry under Call Centers was misspelled. It is vCustomer Corp. (not Customer Corp.).

The Feb. 13 table of contents entry for the page 38 story, “Stung by stock options,” reads: “As the SEC and Justice investigate ex-Brocade CEO Greg Reyes, he’s suing the board.” That is incorrect. It should have said he “may” sue the board.

In “Kick-start your career with MTV” (UpFront, Feb. 13), the correct name of the MTV Networks television channel for college campuses is mtvU. The broadband channel on the mtvu.com Web site is mtvU Über.

“Candy’s getting dandier” (Personal Business, Feb. 13) incorrectly stated that ethel’s chocolate is available in department stores. It is available at ethelschocolate.com. Joseph Schmidt Confections are available at josephschmidtconfections.com and in some department stores.

In “No union please, we’re Wal-Mart,” (Book Excerpt, Feb. 13) on Wal-Mart Stores Inc. in Canada, the reference to the U.S.-Canada border was incorrect. It is the 49th parallel.

well. Here’s the math: \$40,000 x 100,000 jobs equals \$4 billion, x 7½%, which equals \$300 million each year that is not going into the Social Security Fund. It is only right that an employer continue to pay its 7½% into the fund.

Want to save Social Security? Now you know how: Tax every outsourced job.

—Thomas G. Baranski
Memphis

VERIZON SAYS ITS SETUP MAKES “HOGGING” IMPOSSIBLE

RE “IS VERIZON a network hog?” (Information Technology, Feb. 13): Verizon’s FiOS high-speed broadband service transcends the capacity limits of cable and other phone companies’ fiber networks by putting data and video on separate lasers all the way to the home. Our network architecture makes “hogging” impossible, which renders Paul Misener’s assertion that our network “squeeze[s] out the public Internet” absurd.

In addition, FiOS is “future proof,” so it can expand to fit the bandwidth needs of tomorrow. Professor Marvin Sirbu’s mathematics and copper-wire-era assumptions are irrelevant and mislead-

ing because FiOS data and video ride two separate, application-specific paths. Neither competes with nor impedes the other.

At Verizon we agree with Vinton Cerf that there should be no “tollbooth” or other attempts to block access to Internet. Along the same lines, efforts Europe or China to block or control—efforts by some in the U.S. to regulate the Internet must be resisted with vigor.

—David J.
Verizon Communications
Washington

WHO REALLY GOT EX-ENRON WORKERS SOME OF THEIR DUE?

WHILE RICHARD Rathvon has worked hard on behalf of former Enron employees, credit for getting 5,000 fired Enron workers some portion of the severance they were due goes to a group of courageous Enron workers who traveled to Washington, D.C., to seek help in February, 2002 (“I survived Enron,” Special Report, Feb. 6).

Failing to receive aid from Ken Lay’s friends in Washington, these workers brought suit in bankruptcy court—with the help of millions of fellow workers in the labor movement who picketed banks and sent ten thousands of faxes and e-mails to the financial institutions that controlled the bankruptcy process.

During this desperate fight to get former Enron employees a fraction of what they were owed so they could pay mortgages and provide health care for their families, Ken Lay sat silently in his multimillion-dollar Houston penthouse.

—Damon S.
Associate General Counsel
AFL
Washington

How to reach BusinessWeek

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Darwinian Investing

CAN BRAIN SCIENCE unlock the secrets of success on Wall Street? And if so, will it transform the field of personal finance? These matters fascinate Andrew W. Lo, a finance professor at Massachusetts Institute of Technology's Sloan School of Management and director of its Laboratory for Financial Engineering.

Lo, 45, and a small band of economists are tapping into neuroscience and cognitive psychology to better understand how investors make financial decisions. In one early experiment, he and a colleague wired up 10 traders in Boston and monitored their breathing, body temperature, perspiration, pulse rates, and muscle activity as they risked real money in the markets. While the most seasoned traders in the group remained relatively calm, nearly everyone had sweaty palms and quickened pulses when the markets grew more volatile. "Even the best traders have significant emotional responses when they trade," says Lo.

This fights the stereotype of traders as rational, coolly analytical Vulcans of commerce. Lo's results, along with further studies using more sophisticated magnetic-resonance imaging on traders, also undercut a dominant theory known as the efficient market hypothesis (EMH), which holds that markets aggregate information efficiently and investors form their financial expectations rationally. The reality may be much messier.

Lo, who also serves as chief scientific officer at the hedge fund Alphasmix, breaks with both EMH and behavioral economics in seeing emotions as central to survival in the market. But this is just one element in a theory Lo is developing called the Adaptive Market Hypothesis. It shows how investors use trial and error to establish rules of thumb when placing financial bets and then hone their skills amid disruptive changes. Think of the market as an ecosystem made up of hedge funds, mutual funds, retail investors, and other "species," all competing for profit opportunities. It's a Darwinian world where market shifts render some strategies obsolete, resulting in chances missed and money lost, says Lo. "The only way to maintain an edge is to continually innovate."

Lo is not the first to incorporate the insights of Charles

Andrew Lo's market theory borrows from neuroscience, evolution, and econometrics



Darwin in his models. Luminaries from Joseph Schumpeter to Gary Becker explored this territory in the past. But Lo's mingling of neuroscience, evolution, and financial econometrics is highly original. He predicts that the insight of evolutionary psychology will change individual wealth- and risk-management techniques, right down to how people handle 401(k) portfolios or deal with declining home prices.

Prepped with appropriate data from Lo's research, a sophisticated computer program might one day provide invaluable financial advice. You would punch in basic information, such as family status, life goals, the standard of living you would find acceptable in retirement, and the types of risk you can or can't tolerate. An algorithm would then tailor a portfolio for you and help you hedge against unwanted risks, such as a lost job or a wage cut. "Now, it sounds like science fiction," says Lo. "Not in 10 years."

Sci-fi was an important influence on Lo, whose family moved from Taiwan to Queens, N.Y., when he was 5. Raised by his mother, he became an academic star. He skipped eighth grade, sped through Bronx High School of Science and Yale University, and nabbed a Ph.D. in economics from Harvard University at age 24. But it was Isaac Asimov's *Foundation* trilogy that steered him toward finance economics. Asimov sketched out a branch of mathematics called psychohistory, whose practitioners sample the proclivities of large numbers of people, then accurately predict the future based on what they learn. Sound familiar?

—By Christopher Fara

BusinessWeek online For more about Andrew Lo's views on evolution and finance go to www.businessweek.com/extras

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Technology&You

BY STEPHEN H. WILDSTROM

Your Data, Naked on the Net

The U.S. Justice Dept.'s demand for data on how Web surfers use Google and other search engines raises a disturbing question: Just how much do the Web sites you visit know about you? In general, they know a great deal about the aggregate behavior of visitors, and nothing about individuals unless they have chosen to identify themselves. But there are exceptions.

Operators of even the most modest Web sites can learn a lot about visitors, short of pinpointing their actual identities. I manage a site for a small nonprofit. The hosting service, Homestead Technologies, throws in analytical tools from Media Highway International's RealTracker. I can tell the order in which visitors viewed pages, what Web sites they came from, and what search terms they used, among many other things. This information is invaluable for designing effective Web sites.

We don't ask visitors to register, and the only identifying information recorded in the data is a 12-digit Internet address. This normally only links the visitor to a large organization, such as their Internet service provider, employer, or school, and provides no clue to individual identity.

The situation is somewhat different on sites where you have registered. These can link your activity to whatever identifying information you have supplied, anything from a made-up user name and possibly fake e-mail address to your real name, address, and credit card information if you have divulged them. Once you give out that data, your life can be an open book. You can block the collection of personal information by setting your browser to reject files called "cookies," but this will cause many Web sites to work badly or not at all.

THE EXTENT TO WHICH WEB SITES use the data they collect is limited by their privacy policies, which the Federal Trade Commission can force sites to honor. If you live in the European Union, the EU Privacy Directive gives you much stronger legal protections than you get as a U.S. resident.

Privacy policies vary greatly. Google promises not to share any personally identifiable data with third parties without explicit consent. But BusinessWeek Online, like many commercial sites, reserves the right to share information (other than credit card data) with "selected outside companies whose products or services we feel may be of interest to you" unless an individual explicitly opts out.

There are, unfortunately, two factors that could put your privacy at much greater risk than you'd anticipate. One is



What's jeopardizing your privacy? Tech progress and the U.S. government

advanced technology, the other growing government appetite for information. Progress in mathematics and computer science is making it possible to assemble tiny, disparate bits of information into a comprehensive picture of an individual. For example, studies have shown that 87% of the U.S. population can be uniquely identified via only a date of birth, sex, and five-digit residential code. Someday you may be identifiable just from your tastes in books, movies, and sports as revealed by your Web browsing.

Government inquisitiveness is a much more immediate risk to privacy. The request that Google is fighting seeks only search terms, but the Justice Dept. could have asked for the Internet addresses that went with them. Then it could ask Internet service providers and other network

operators to identify the people those addresses were assigned to, pinpointing the source of the request. And it's just the government: The music industry has used similar techniques to identify the users of illegal download services.

There's not a whole lot you can do to prevent this data from being collected. You can use an anonymous proxy service, such as Anonymizer, but it can interfere with your use of the Web and can't guarantee to hide your identity in all circumstances. Or you can live with the fact that what you do on the Web cannot be regarded as truly private. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Knight Ridder's Happy Ending?

If the Knight Ridder Inc. sale saga were to have a Hollywood ending, it would look like this: The McClatchy Co. and the New York Times Co. tear up to outbid a consortium of private equity firms to buy the company's 32 dailies. Consider the scenario. Tony Ridder, family scion running a battered company formed by the merger of two family-owned chains,

safely steers his properties out of troubled waters and toward a partnership of two family-owned newspaper companies, both of which boast solid journalistic reputations. Ridder's black hat turns white. The Times Co. and McClatchy win industry kudos for blocking a private equity takeover. Sighs of relief from Knight Ridder staffers mean goodwill for contract talks.

The two companies could combine their big-city outlets with Knight Ridder's to create a formidable network to sell ads across the land. At the same time, they could slice some costs, and the Times Co. could extend its brand by funneling its journalism into a host of new properties. Since both McClatchy and the Times Co. have family-controlled stock structures, they would be able to weather, at least in the short term, the drubbing they would take from Wall Street, which likely will frown on newspaper companies doubling down on newspapers.

The companies have investigated the possibility of teaming up on a bid, say some insiders. (Company spokespeople declined to comment.) The Sacramento-based McClatchy, headed by CEO Gary B. Pruitt, is the wild card in the sale process. Onlookers say McClatchy could come up with the expected \$6 billion, more or less, needed to win Knight Ridder, but it would mean taking on heavy debt for a company that did just under \$1.2 billion in revenues last year. (The Times Co. notched \$3.3 billion in revenues in 2005.)

A McClatchy-Times partnership would bring breathing room and a stack of complementary strengths. The Times Co. has big-city (and big-union) bona fides. McClatchy, skilled in operating in smaller markets, could run the 15 smaller Southeastern and California newspapers in the Times's Regional Newspaper Group.

The Times Co. has stressed its flagship's national strategy and could make that footprint bigger by adding Knight Ridder properties in Philadelphia, Miami, Kansas City, Fort Worth, San Jose, Charlotte, N.C., and Seattle (where Knight Ridder owns 49.5% of *The Seattle Times*). The two companies could wrap McClatchy papers in Minneapolis, Raleigh, N.C., and Sacramento into an ad network, as well. The combined



entity would become an industry heavyweight, in both quality and heft. And Pruitt's high regard on the Street might soften market reaction. "It's a workable solution," offers one Street source. Pruitt has "a good rep, and deservedly so."

Some things to note: One, these details are wholly hypothetical. Two, newspaper companies have made small-scale swaps and side deals, but nothing approaching this. And the Times Co. has struggled with its *Boston Globe*. Adding Philadelphia—perhaps the prototypical troubled big-city market—might look like the company is

mating two dogs in the hope of creating a pony. Any merger brings strains, and this one's stakes would be high. Group 1 for Knight Ridder face a massive tax hit if any properties are sold before several years elapse, says an executive familiar with the terms. And the Times Co. has always played well with other its recent takeover of the *International Herald Tribune*, longtime partner Washington Post Co. attests.

A company with assets like these comes up for sale just once in a lifetime

Much ink has been spilled, here and elsewhere, about the threats newspapers face. But putting information on newsprint and serving it up online is what newspaper people like those running McClatchy and New York Times Co. know how to do. And newspaper people will believe in the medium until the last daily dies. A company with Knight Ridder's assets hits the market once in a lifetime, if that. A newspaper exec mulling the media chessboard knows that Knight Ridder may be the only chance to buy big when the medium's reputation is lowest. In the end, it's almost as much a rescue operation as a land grab.

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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JAMES C. COOPER

Low Unemployment Raises an Old Inflation Debate

Should the Fed keep hiking rates in the face of a tighter labor market?

U.S. ECONOMY Remember NAIRU? Sounds just like “Nehru,” but not one of those collarless jackets popular in the 1960s. NAIRU is an acronym for Non-Accelerating Inflation Rate of Unemployment, the clunkiest phrase economists ever devised. It was last heard amid an inflation debate in the late '90s. In plain English, NAIRU is the

rate at which the unemployment rate can go without generating sustained pickup in inflation. On the heels of the strong recovery in the labor market, the debate now begins anew: Should policymakers and investors start to worry about the inflation implications of tight labor markets? Vigorous job growth, including 687,000 new payroll jobs in just the past three months, pushed the jobless rate down to a 4½-year low of 4.7% last month. Hourly pay of production workers, up 3.3% from a year ago, is rising at its fastest pace in nearly three years. And job growth is generating plenty of income to support consumer spending, which is a key reason for the economy's upward thrust in early 2006. That momentum will only strengthen the labor markets further.

At the end of last year, the Federal Reserve first voiced concern that “possible increases in resource utilization as well as elevated energy prices have the potential to add inflation pressures.” That's the Fed's speak for “if the labor markets get too tight, we might have to take policy past the neutral zone into an area that actually restricts economic activity.” Back then, the unemployment rate at 6%, job growth was hobbled by the hurricanes, and the economy appeared to be slowing down. Now the picture is starting to look less inflation-friendly.

AS CLEAR IN THE LATE '90s, the importance of NAIRU is more theoretical than practical, because the rate was a moving target, shifting from business cycle to business cycle with the changing structure of the economy. Recall that, by 2000, the jobless rate had slipped a tick below 4% with little evidence that inflation pressures were building in any big way.

However, 2006 may well be different from the late '90s, because the unemployment rate may not have as much room to fall as it did back then. Inflation in the late '90s was restrained by several forces. Fed policy was largely in the restrictive zone, based on the Fed's non-adjusted policy rate, even before the Fed began tightening in 1999. A global production capacity glut following the Asian crisis in 1997 sent deflationary waves rippling through the world economy. The dollar was strong, holding down import prices. And productivity growth was accelerating as new technology blossomed.

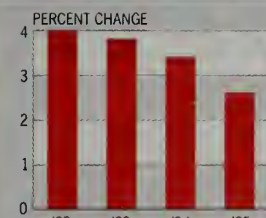
In 2006, Fed policy is only neutral, and it has been exceptionally loose for four years. Global competition still is clearly anti-inflationary, but domestic demand in global economies is either strong, as in China and the rest of Asia, or improving, as in Japan and the euro zone. The broad trade-weighted dollar has fallen 15% from its peak in early 2002, with further declines likely this year. And

importantly, productivity growth is now slowing (chart).

Productivity of nonfarm businesses in the fourth quarter fell at a 0.6% annual rate from its third-quarter level. That drop was worsened by the weak fourth-quarter gross domestic product, which was distorted by several temporary factors.

Both GDP and

PRODUCTIVITY GROWTH IS TAPERING OFF



Data: Bureau of Labor Statistics, Global Insight Inc.

productivity will look stronger this quarter, but the slowing trend in productivity will remain in place at a time when labor markets are tightening and wages are starting to grow faster. Slower productivity growth reduces the ability of businesses to offset higher labor and other costs, increasing the pressure to lift prices.

PRODUCTIVITY OVER THE PAST TWO YEARS has grown at a 2.4% annual rate. That's not bad in a historical sense, but it's the slowest two-year pace in almost five years. The pace will most likely cool off further in 2006. In recent years companies have been exceptionally hesitant to invest and hire amid the uncertainties of corporate scandals, war, and energy shock. Businesses have satisfied demand with their existing facilities and payrolls. That reluctance temporarily boosted productivity.

But corporations have taken their short-term efficiency gains about as far as they can. With demand still strong, the recent robust job gains suggest that companies are ready to rely more on additional workers and less on greater productivity to meet their growth in

production. That pattern doesn't rebut the improved long-term outlook for productivity growth, but in the short term, it is a typical trend as an economic expansion matures. It just took a little longer for it to show up this time.

The inflation concern is that productivity is slowing at a time when wage growth is picking up. That's a recipe for faster increases in unit labor costs, which correlate with inflation outside of energy and food. Over the past two years, the yearly growth of hourly pay of production workers has accelerated from 1.6% to 3.3% in January. In the fourth quarter, a broader measure of hourly pay, the Labor Dept.'s employment cost index, showed the first rise in yearly wage growth in two years. Amid resilient demand, businesses have a little more pricing power and thus greater ability to cover their higher costs.

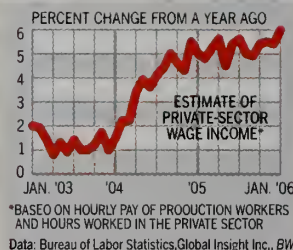
It's also interesting to note that the employment cost index for benefits has slowed sharply during the past year, from a 7.1% yearly pace to only 4.1% last quarter, reflecting mainly a tight reining-in of health-care costs. Greater control over benefits will give companies more leeway to grant hikes in regular pay in order to attract workers with the particular skills companies need.

THE OTHER SIDE OF STRONGER JOB MARKETS is the support they are providing consumer confidence and spending. That will be important in the coming months, as housing and home values cool off, and as households stop using their homes as ATMs.

The underlying momentum of income growth shows up in a calculation based on recent labor market data on

jobs, the workweek, and hourly pay. This gauge tracks the trend in overall wages and salaries, although it includes only production workers and excludes bonuses and other forms of pay such as stock options. In January it was up 6% from a year ago, the strongest yearly pace since before the recession began in early 2000 (chart).

HOUSEHOLD INCOME'S FIRM UNDERPINNINGS



Little wonder why January consumer confidence hit a 3½-year high.

To some extent, recent job gains reflect a bounce back from the hurricane and unusually mild January weather. However, over the past year, monthly job growth has averaged about 175,000 slots per month. As a result, the

unemployment rate has declined by half a percentage point. If job growth continues at that rate, and the extremely low level of new unemployment claims heading into February suggests that it will, then the jobless rate could be below 4.5% by summer.

So, while the key NAIRU level remains fuzzy, what is clear is that the economy moved a lot nearer to it in January than anyone expected it to only a few months ago, and that marker will get even closer in coming months. ■

BUDGET DEFICITS

The CBO's Forecasts Look Too Rosy

THE MASSIVE budget deficits of recent years are starting to shrink, according to the Congressional Budget Office. But as CBO officials readily admit, the agency's projections don't fully capture reality.

The nonpartisan CBO, which must assume no changes in current law, expects a deficit of \$337 billion this fiscal year, ending on Sept. 30, falling to \$270 billion next year. By 2012, the budget would be roughly in balance—with a surplus of about \$38 billion.

But those estimates are not shared by private economists, who can make more realistic political forecasts. According to Kathleen Stephansen, director of global economics at Credit Suisse Group,

the fiscal 2006 deficit will hit \$394 billion. The shortfall is projected to swell to \$514 billion by 2012.

The problem is the CBO must make some unlikely assumptions. Future discretionary spending—non-mandatory outlays that are decided each year—must be assumed to grow at the same rate as expected inflation, or 2.8% for 2006 and about 2.2% after that. Since 1965, discretionary outlays have risen by 6.4% on average, and Stephansen forecasts spending growth of 10% this fiscal year and no less than 5% in the coming decade.

The fiscal 2006 estimate by the CBO also omits the additional funding for operations in Iraq and Afghanistan, as well as outlays to cover

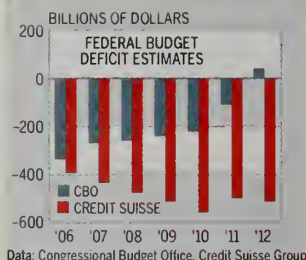
insurance claims after Hurricane Katrina. By the CBO's own admission, this would push the 2006 deficit to about \$360 billion.

Plus, spending and revenue projections must also be based on current tax laws. So the CBO assumes that the tax cut provisions passed in 2001 and 2003 will all sunset as currently scheduled. But in the latest budget proposal it is clear that the White House will be fighting hard to make permanent as many of the current tax breaks as possible.

Larger deficits also mean bigger interest payments, especially if the Fed's rate hikes start pushing up long-term rates or if foreign investors begin parking their money elsewhere. And the task of trimming deficit only gets tougher starting in 2007 when the oldest baby boomers begin collecting Social Security retirement benefits. ■

—By James Mehring in New York

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The Business Week

News you need to know

EDITED BY ROBIN AJELLO



A Hard Shove Kirk Kerkorian is one powerful hombre. His point man, **Jerome York**, had barely been named a **General Motors** director on Feb. 6 before the GM board began moving on a laundry list of York/Kerkorian demands, er, suggestions. At the top of the list: slicing the \$2 dividend down the middle, a move GM expects to add up to more than half a billion in cash savings this year. And now the pain is being felt even at the top. **CEO Richard Wagoner Jr.** (above) will take a 50% salary cut in fiscal 2006, or about a million bucks; his direct reports, including car czar **Robert Lutz**, will get 30% less than before. And those 2005 bonuses? Fuhgeddaboudit. Besides saving the auto maker a tidy sum, York and Kerkorian hope the givebacks in the executive suite will put the union in a less surly mood—and more willing to make its own concessions next year.

See “You’ve Got the Floor, Kirk,” page 61, and “At GM, the Kerkorian Effect Already?” www.businessweek.com/go/tbw.

Low Fat Isn't Phat So, eating fat-free yogurt and fruit doesn't help ward off illness after all. Or so says a new study of 49,000 American women, released on Feb. 8. It finds that eating a low-fat diet doesn't reduce the chances of getting cancer or heart disease. Does this mean you should hop in the SUV and head to the nearest fast-food joint? Probably not. Health studies have a nasty habit of being overtaken by... new studies.

See “Skip Your Veggies? Not So fast,” page 44

Pfizer is Listening It's more Band-Aid than cure-all. On Feb. 7, **Pfizer** announced it was considering selling or spinning off its consumer business (2005 revenues: \$3.9 billion). Analysts figure the unit, which makes such over-the-counter brands as Listerine and Benadryl, could fetch to \$11 billion. The news sent Pfizer stock up nearly 6% the next day, to about \$26. But the plan doesn't come close easing the drugmaker's real headache: expiring patents on its biggest drugs and a scarcity of new blockbusters in its medicine cabinet. Still, **CEO Henry McKinnell Jr.** seems to be getting the message from weary shareholders, who have watched Pfizer's stock go pffft for half a decade.

See “Pfizer Feels Investors' Pain,” page 48
www.businessweek.com/go/tbw

Bleak House Is the McMansion dead? Probably not. For companies that build those gazillion-square-foot palaces, the market is feeling a little less expansive. On Feb. 7, **Toll Brothers**, the nation's No. 1 builder of luxury homes, announced that the value of orders for its quarter ended Jan. 31 were down 2% over the previous year. It was another sign that the U.S. housing market is coming back to earth with what optimists hope won't be a thud. Toll Brothers' revelation, which came to analysts by surprise and hammered the stock, was followed by the news that inventories of existing homes are rising exorbitantly in major cities around the country. All of which is better news for buyers than it is for sellers.

See “If You Build It, They Might Not Come,” page 52
and “Is the Bell Tolling for Housing?” page 54
www.businessweek.com/go/tbw

Man on a Mission **Carl Icahn** sometimes seems like a Quixote, tilting at windmills in his, well, quixotic, battle to bend **Time Warner** to his will. On Feb. 7, the corporate giant released a novel-sized report—371 pages, authored by **Lazard**—laying out his restructuring vision. His plan is to break the company into four publicly traded pieces: publishing, cable, and **AOL**, along with a studio-cable unit. Icahn also wants TW to buy back \$20 billion in stock. So far, most shareholders have panned the plan. But Icahn may be having some impact on **CEO Richard Parsons**. TW on Feb. 7 sold its book publishing unit to France's **Legardere** for \$537.5 million. And TW is planning to spin off a 16% stake in its cable unit and buy back \$12.5 billion in stock.

Dialing for Dollars If you can't find a buyer, do the best thing: go public. On Feb. 8, **Vonage Holdings**, the top independent provider of Internet-based phone service in the U.S., announced that it will float a \$250 million offering in the coming months. Vonage also named a new CEO, former **ADT Security Systems** President **Michael Snyder**.

More Guns, Less Butter President **George W. Bush's** proposed federal budget is great news if you happen to be at the Pentagon. The \$2.77 trillion budget Bush sent to Congress on Feb. 6 set aside an extra \$28 billion for defense for a total of \$439 billion. Homeland security would get another \$1 billion. In an effort to balance the books, B

is a whack at domestic programs, including Medicare and education. Reining in such popular programs is likely a starter in an election year. And the budget would still show a deficit of \$354 billion for fiscal '07.

See "Death, Taxes, and George W. Bush,"
www.businessweek.com/go/tbw

Pepsi Goes Pop Meet the new Pepsi Generation. Sales at the U.S. beverage and snackmaker grew a fizzy 15% during the quarter ended Dec. 31. And much of that growth happened in overseas markets, which accounted for more than a third of **PepsiCo's** \$10.1 billion in fourth-quarter revenues.

Name Changer? Toys 'R' Us has a new CEO, former Sears Vice-Chairman **Gerald Storch**, 49, who was named on Feb. 7. Sorting out the toy merchant will be anything but easy on his play. Eleven months after **Kohlberg Kravis Roberts**, **Capital Partners**, and **Vornado Realty Trust** paid almost \$7 billion for Toys, a turnaround remains a work in progress. A January announcement that the company will close 75 of its U.S. stores and lay off 3,000 people left analysts cold.

One Page Good news for real estate addicts. On Feb. 8, **Expedia.com** founder **Rich Barton** unveiled his site **Zillow.com**, which uses public records to crunch appraisals for about 100 million U.S. homes—all without sharing personal data or meeting with a sales rep. The ad-supported site crashed repeatedly after heavy publicity attracted swarms of visitors. But Barton kept cool: Keeping a promise to Zillow's developers, he shaved his head down to a brush cut as a reward for getting the beta version up on time.

See "A New Home Site on the Block,"
www.businessweek.com/go/tbw

Stock Woe of the Week

As everyone knows, **Apple Computer** has been on quite a tear in recent years. So how come this high-flying stock has lost some altitude? Just a few weeks ago, the much-lauded maker of iPods and Macs eclipsed the \$72 billion market cap of **Dell**. That was quite a feat since Dell's sales dwarf Apple's by four to one. Well, the giddiness didn't last long. As of Feb. 8, Apple's stock had fallen 20% from its Jan. 13 high of \$85.59. Did the news that Apple had passed Dell tell investors that the stock was getting ahead of itself? That may be part of it. More likely, investors are being out over concerns of slower-than-expected demand for Apple's new Intel-equipped Macintoshes. Factor in, too, the sense among shareholders and investors that **Steve Jobs's** next big product introduction may be several months away. Even the lower-priced iPods, unveiled Feb. 7, failed to lift the stock north of \$70.



STEVE JOBS



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LOBBYING

SHAKEDOWN ON K STREET

Even in the face of the Abramoff scandal, lawmakers are still using high-pressure tactics to squeeze donations out of Washington lobbyists

BY RICHARD S. DUNHAM AND EAMON JAVERS

THE CONVENTIONAL WISDOM: Crass corporate lobbyists lavish millions of dollars on lawmakers in a transparent attempt to buy influence on Capitol Hill. But in the carpeted corridors of K Street, the 11,500 people who earn their living in the influence-peddling profession know a different reality. More often than not, they understand that money is vacuumed up to Capitol Hill by demands from members of Congress. "Everybody thinks it's the interest groups buying the members," says John J. Pitney Jr., a political scientist at Claremont McKenna College in Claremont, Calif. "A lot of the time it's the members shaking down the interest groups."

Despite the guilty plea of fallen super-lobbyist Jack Abramoff, Capitol Hill doesn't hesitate to turn to K Street for campaign cash. One prominent business lobbyist was so aggravated by attacks on his brethren by money-raising members of Congress that he collected every fundraising invitation letter he received for a month. The total for January: more than 60. He dutifully sent checks for most even

though he says that he has never asked half of those lawmakers for anything. "I'm doing it because it's expected," he laments. "If you want to be in the game, you've got to pay."

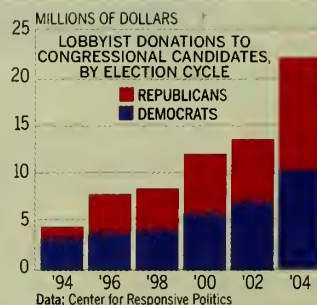
That game can be expensive. One Washington lobbyist who asked not to be identified says he gave money to the unsuccessful Democratic candidate for a House seat. After the election, the Republican winner called to demand a check—bigger than the original gift. Why? "The late train is a hell of a lot more expensive than the early train," the lobbyist says he was told.

Lawmaker solicitations are legion and often quite creative. Take the case of House Financial Services Chairman Michael G. Oxley (R-Ohio) and his book club. Each month a junior member of Oxley's committee picks a book and distributes copies to financial lobbyists to read and discuss. The price of admission is a contri-

bution to the featured member. The lobbyists get face time with Oxley, who largely controls the Washington agenda for his industries. Oxley, who is retiring in 2006, wins the loyalty of his low-ranking colleagues by helping them score congressional nominations. But the sessions are hardly educational: Panel members' tastes run more on motivational screeds than to tomes of finance, attendees say. "I've never read any of the books," says a regular. "Are you reading me? Read? I went to law school."

Advancing literacy in the legal profession isn't the point. While Oxley has personally pressed him to ante up, say other financial-services lobbyist, he feels compelled to attend. "It's like I have to give, though I never otherwise would, because it's coming from Oxley," the lobbyist says. Oxley aides not return requests for comment. If Oxley has created a group of rela-

CAPITOL INVESTMENT



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bookworms, House Energy & Commerce Committee Chairman Joe Barton (R-Tex.) has revived the charm of an old-fashioned ride on the rails at newfangled prices. For just \$2,000 a person (or \$5,000 per PAC), lobbyists were given the opportunity on Jan. 20 to spend almost eight hours with the chairman aboard a train bound for San Antonio from Fort Worth. In a glossy brochure Barton described the event, which included a rolling game of Texas Hold 'Em and an after-hours visit to the Alamo, as "a hot ticket." Barton's campaign consultant did not respond to repeated requests for comment.

A not-so-movable feast was hosted by Senate Judiciary Committee Chairman Arlen Specter (R-Pa.). Lobbyists for warring sides of the asbestos trust fund legislation were invited to a \$500-a-head, \$1,000-per-PAC event at Specter's Georgetown apartment on Feb. 6. Specter says it was coincidental that his annual birthday fundraiser was scheduled one day before the Senate debated the asbestos bill, which Specter co-sponsored. "No special group has been targeted," Specter says.

Republicans have no monopoly on Washington's fund-raising bazaar. One lobbyist recently received an invitation for a Mar. 8 fundraiser for Representative William J. Jefferson (D-La.) at Democratic National Committee headquarters. The invitation prominently noted Jefferson's service on the tax-writing House Ways & Means Committee. It did not mention that a federal grand jury may be probing his dealings with U.S. businesses trying to land contracts in Africa. A former Jefferson aide has pleaded

Show Them **The Money**



ARLEN SPECTER
(R-PA.)

The Senate Judiciary Committee Chairman invited asbestos lobbyists to a \$500-a-plate birthday dinner a day before the Senate started debate on a trust fund to pay asbestos victims.



JOE BARTON
(R-TEX.)

The Chairman of the House Energy Committee charged \$2,000 a person for almost eight hours of poker and elbow-rubbing aboard a luxury train from Fort Worth to San Antonio.



WILLIAM JEFFERSON
(D-LA.)

The representative trumpets his Ways & Means membership for a \$2,500-a-PAC reception—but doesn't mention a possible federal grand jury probe into allegations of kickbacks.

guilty to aiding and abetting bribery of a federal official. Jefferson has denied wrongdoing. Both his congressional office and campaign fund-raiser declined to comment.

Such invitations are the rule, not the exception, in Washington, where campaign shops churn out fancy engraved

invitations and spam e-mail targeting K Street. One GOP lobbyist says that in prime fund-raising season he receives five to six e-mails a day from the Bellwether Consulting Group, a GOP fund-raising firm in Washington. "I don't open 'em. Delete, delete," he says.

Sometimes the squeeze isn't the least bit subtle. One lobbyist, who requested anonymity, returned from a meeting with a Democratic senator to find a message on the office voice mail saying where the check could be sent.

Capitol Hill's high-pressure tactics aren't new. Former House Majority Leader Tony Coelho (D-Calif.) first targeted the lobbying community in the mid-1980s when he chaired the Democratic Congression-

rocketing cost of campaigns, particularly television advertising. "Unless and we stop the outrageous expense of political campaigning in America, we're going to continue to be beholden to those who are well-off and well-connected," Senator Dick Durbin (D-Ill.). "You've got to spend a lot of time on the phone begging for money."

But grasping politicians can't put the blame on expensive campaigns. Incumbents choose to raise oodles of money to discourage serious competition and create bulging war chests to pass along to colleagues. The benefit: They collect money for future leadership contests.

Some lobbyists are having second thoughts about today's pay-to-play market. "As a conservative, I've always opposed government involvement," Stanton D. Anderson, a Washington business lobbyist. "But it seems to me that the real answer to this so-called lobbyist reform crisis is federal financing of congressional elections."

That kind of radical change won't happen in Republican Washington. Proposals to bar lobbyists from donating to lawmakers or raising money for them have little chance of winning among the incumbents whose seats are protected by the current system. Some denizens of K Street wouldn't want a ban. "Please, make it illegal for lobbyists to give money to political campaigns," says one Republican business rep. "Make my day."

—With Lorraine Wolf
in Washington

Deep Pockets

Top 10 corporate political givers* in the 2004 election cycle

COMPANY	MILLIONS
Goldman Sachs	\$6.5
Microsoft	3.5
Morgan Stanley	3.4
Time Warner	3.4
JPMorgan Chase	3.1
Citigroup	2.9
Bank of America	2.7
UBS Communications	2.5
SBC Communications	2.4
United Parcel Service	2.4

*Includes corporate PAC contributions and gifts of \$200 or more by individuals reporting a relationship with the company

Data: Center for Responsive Politics, from Federal Election Commission filings



BBYING

SEARCHING FOR RESPECT ON THE HILL

Google has repeatedly rankled the GOP. Now it's trying to smooth things over

KATHERINE YANG

GOOGLE INC. HAS A Washington problem. Since it started hiring for its public policy team last year, the Web giant hasn't snagged a single high-profile Republican.

ned, Washington's GOP ruling elite ngiving Google the time of day.

he Republicans can't seem to forgive y they see as Google's leftward tilt. In ae 2004 federal election

ye, 99% of Google em- loe's campaign contri- uons went to Demo- ral. For its first lobbyist, he company last May ir, Alan Davidson, a De- no at and former privacy policy wonk at he enter for Democracy & Technology hit. tank. And now Google has taken osions on two issues that rankle many e Right: rebuffing U.S. government

subpoenas to help track child pornogra- phers, while bowing to the censorship de- mands leveled by China's communist government as the price of doing busi- ness in that country. "It sends a signal that the company doesn't know who its friends are," says a GOP lobbyist.

Davidson says he recognizes Google's GOP problem: "We take the critique seri- ously," he told *BusinessWeek*. Google last year had offered former White House aide Dan Senor a key communications job at

“They have to learn how to make Washington work. It's not organized like a Google search engine.”

—Jerry Berman, president of the Center for Democracy & Technology, a Washington think tank.

its California headquarters, but he de- clined to move. Now, Davidson is in the market to hire an in-house Republican lobbyist in D.C., but so far heavy-hitting GOP prospects aren't biting. "I'd have a hard time explaining [a job with Google] to my friends on Capitol Hill," says one Republican lobbyist.

At least one prospect, Michael Sulli- van, an aide to Senator John Ensign (R-Nev.), has given Google the thumbs- down, according to lobbyists. Sullivan declines to confirm or deny the account. Google says it just posted the opening, hasn't made any job offers, and won't discuss specific candidates.

Google may get a first taste of potential repercussions from its GOP problem when it explains its China policy at a Feb. 15 hearing of the House Global Human Rights Subcommittee. "It is astounding that Google, whose corporate philosophy is 'Don't Do Evil,' would enable evil by cooperating with China just to make a buck," says the panel's chairman, Chris Smith (R-N.J.). Google says its presence in China will benefit Internet users there more than if it boycotts the country.

Cynics think Google could negate many such criticisms by dangling the right price for an in-house GOP lobbyist. But longer-term, can a company with the motto "Do No Evil" actually do business in Gucci Gulch? "They have to learn how to make Washington work," says Jerry Berman, CDT President. "It's not organ- ized like a Google search engine."

Many in Washington see arrogance in Google's approach. They think the Net giant, which is rewriting the rules of business, wants to rewrite the rules for Washington, too. The company has no political action committee and seems to prefer brokering ideas to politicking. "They're drawing a big bull's-eye on [Google's] head," says a GOP strategist. "Washington has a record in dealing with big, arrogant, growing compa- nies." Remember Microsoft Corp., whose dismissive attitude toward the capital helped fuel a U.S. antitrust case.

Davidson denies that Google thinks it's above the fray. "We respect how things work here in Washington," he says. "We hope we can use our visibility to make a difference." He recently hired two outside lobbying firms with GOP ties, Gage LLC and PodestaMattoon. And he says the company is considering starting a PAC.

Still, Davidson knows he has only so much time to win friends and influence people. First up is to find some GOP pals. ■

—With Eamon Javers in Washington

CENSORSHIP

OUTRUNNING CHINA'S WEB COPS

Net-savvy outfits are finding ways to let citizens see banned sites

BY BEN ELGIN

FROM AN UNDISCLOSED LOCATION in North Carolina, Bill Xia is fighting a lonely war against China's censors. From morning till well into the night, the Chinese native plays a cat-and-mouse game, exploiting openings in Beijing's formidable Internet firewall and trying to keep ahead of the cybercops who patrol the Web 24-7 and have an uncanny ability to plug holes as quickly as Xia finds them. A member of the banned Chinese sect Falun Gong, Xia is so fearful that Beijing will persecute his family back in China, that he refused to be photographed for this story, reveal where exactly he was born, or even provide his age beyond saying he's in his 30s.

Xia is part of a small group of Chinese expatriates who are making a modest living helping Web surfers back home get the information their government would rather they not see. Chinese citizens hoping to read about the latest crackdown on, say, Falun Gong or the most recent peasant rebellion in the provinces can use technology provided by Xia's Dynamic Internet Technology Inc. to mask their travels to forbidden Web sites.

Voice of America (VOA) and human rights organizations also are paying DIT to help evade the censors and get their

message out to the Chinese masses. Says Xiao Qiang, who teaches journalism at the University of California at Berkeley and runs the China Internet Project: "These tools have a critical impact because the people using them are journalists, writers, and opinion leaders."

So far, DIT, UltraReach, and other outfits like them have lured less than 1% of China's estimated 110 million Net users. But Google decided in January to censor information inside China, a practice already followed by Microsoft and Yahoo!, arguing that it's the only way the search engines can crack the Chinese market.

So Xia is convinced that the services he and others provide will become increasingly crucial to keep information flowing and, ultimately, he hopes, build an open society back home. "Once in a while I feel more homesick than usual," says Xia, who says he hasn't seen his family in seven years. "But it's such a great project, and it helps so many people."

The seeds of DIT were sown when Xia arrived in the U.S. for grad school in the '90s. Stunned by America's openness, he realized his perception of reality had been warped growing up in China. "I was a be-

liever of the propaganda," he recalls. When Xia was exposed to all of the information on the Internet, it "started tearing apart what I'd accepted before." At the same time, the repression of Falun Gong at home angered him, though he insists Beijing's curbs on free expression led him to found DIT in 2001. A year later he began building up a roster of clients including VOA, Human Rights in China (HRIC), and Radio Free Asia.

FLEETING WINDOW

THE SIMPLICITY OF DIT's approach lies its effectiveness. The company tributes software, called FreeGate, which disguises the sites a person visits. In addition, DIT sends out mass e-mails to Chinese Web surfers for clients such as VOA, which is banned in China. The e-mails include a handful of temporary Web

A Daily Game of Cat and Mouse

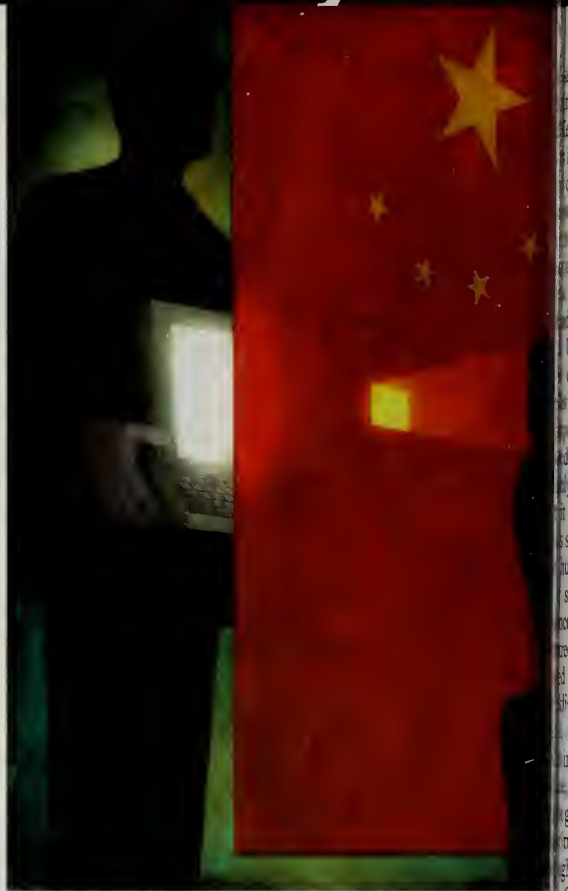
How the battle between authorities and their opponents plays out:

■ Censored sites, such as Voice of America, establish so-called **proxy sites**, which use a special, uncensored address (i.e. notcensored.com) but takes users to the same content.

■ Companies such as Dynamic Internet Technology and UltraReach send out mass e-mails alerting Chinese Web surfers to the latest **uncensored addresses**.

■ The uncensored sites set up a **secure connection** for each visitor, who can then freely peruse the Internet, including sites banned by the Chinese government.

■ China's censors **stamp out the temporary sites** often within a day or two. A new set of proxy Web sites are then unleashed, and the process starts all over again.



ses that host off-limits content and igboards to other forbidden sites. eeping one step ahead of the cen- is what this game is all about. Chi- cybercops are so efficient that these ways typically stay open for only 72 s, according to Ken Berman, an in- ation technology director at the e Dept.-affiliated International dcasting Bureau, which hired DIT UltraReach to help make VOA's content available in China. t despite being outmanned and cent—Xia has a tiny staff, an annu- dget of about \$1 million, and relies ly on volunteers—DIT's customers t has been remarkably successful. staff monitors the success rate of undreds of thousands of e-mails send out each day. If one gets ced back, the language must be red and the offending words de- d and added to the company's list. Workarounds are often devel- , much like spammers finding s in a corporate e-mail filter. For in- e, an e-mail that contains "VOA" t get squelched, but one with a zero tituted for the "O" could get igh.

Google and other U.S. search anies increasingly cooperate with ng, DIT is helping the groups like R break through the firewall. Before ole began censoring its results in ha in January, HRIC appeared in the pree search results. Although Chi- a Google users would have had diffi- ul accessing the HRIC sites, which are ored, they at least knew they existed. ocy they don't appear at all in China. u thanks to DIT and others, visitors to s Chinese-language newsletter spiked ore than 160,000 in January, up six- oln the past 18 months. Says Xia: "If nformation isn't available on the Inter- ett might as well not exist."

ery time something momentous apens in China—and Beijing smoth- ews about it—more people use his ofare, Xia says. In 2003, when the A epidemic peaked and Chinese au- oities seemed to be withholding in- oration, the number of DIT users pld by 50%, he says—and they dou- le after reports surfaced in December ha Guangdong police had shot ro sting villagers.

Sch moments invigorate Xia, mak- ne effort worthwhile. And by the ol of things, the services he and his ee provide will be in demand for uia while to come. ■

With Bruce Einhorn in Hong Kong

UNIONS

CHECKING IN? FIRST PASS THE PICKET LINE

The group that split from the AFL-CIO is behind a massive bid to recruit hotel staff

BY AARON BERNSTEIN

IF YOU'RE THINKING ABOUT staying at a Hilton this year, brace yourself for possible strikes and noisy demonstrators out front. On Feb. 15 the hotel workers' union plans to kick off a national campaign aimed at signing up tens of thousands of employees across the country at Hilton Hotels Corp. and Starwood Hotel & Resorts Worldwide Inc., which owns the Shera-

attempt to organize their employees.

The hotel campaign marks the first major push by Change to Win, the new labor federation that broke away from the AFL-CIO last summer. The 5.4 million-member group, which includes the Teamsters as well as UNITE HERE, wants to stanch labor's decline by mounting national recruiting drives involving entire industries. "We're challenging our industry to make service jobs middle class," says John W. Wilhelm, president of UNITE HERE's

hospitality division, which represents 90,000 of the 500,000 employees at full-service U.S. hotels. Nationally, nonunion hotel housekeepers earn an average of \$8.67 an hour, vs. \$13 for those in the union, according to the Bureau of Labor Statistics.

Over the past several years, UNITE HERE has been aligning the expiration dates of its contracts in major cities so they renew this year. As a result it can

BIG NAMES Actor Glover will join a four-city publicity tour

mount simultaneous strikes in Hilton and Starwood's most lucrative markets, including New York, Chicago, Los Angeles, Honolulu, and San Francisco.

The seven Change to Win unions vow to turn out their members for demonstrations and rally politicians and religious and civic leaders to their cause. Business travelers don't have a direct stake in this fight. But if the new labor federation comes out firing with both barrels as it has threatened to do, they could get caught in the middle. ■



ton, Westin, and four other chains.

The union, UNITE HERE, has lined up big names to publicize its cause. Actor Danny Glover, the son of two union activists, and former Senator John Edwards, whose father worked in a mill, will join hotel workers for a four-city publicity tour. They'll be backed by rallies in 120 cities over the next several months aimed at pressuring the chains to allow their U.S. workers to unionize.

They're in for a tough fight. "We don't think this is a national bargaining issue," says Joseph A. McInerney, CEO of the American Hotel & Lodging Assn., who is speaking for both Hilton and Starwood. The companies won't stand idly by while the unions



HOMEBUILDING

IF YOU BUILD IT, THEY MIGHT NOT COME

With inventories rising, investors have soured on big builders' expansion plans

BY PETER COY

S PRAWLED ACROSS THE desert near a town called Surprise, the Arizona Proving Grounds are flat, dry, and featureless—perfect for testing automotive endurance. Now homebuilder Toll Brothers Inc. has targeted this desolate land—35 miles from downtown—for the next expansion of metro Phoenix. Last month the Horsham (Pa.) builder and two partners announced the purchase of the 5,500-acre Daimler-Chrysler Corp. facility for \$312 million in what the *Arizona Republic* called the most expensive land deal in state history. “This particular parcel is a highly coveted site,” Toll Brothers Chief Executive Robert I. Toll crowed.

But with inventories of unsold homes rising, the days when investors cheered homebuilders' expansion plans are over. Wall Street began to sour on builders last summer, even before it dawned on most homebuyers that the market was topping out. Most homebuilders' stocks are down 15% to 25% since last July. The prices of Toll, Centex, Pulte Homes, Lennar, D.R.

Horton, and KB Home are only about six times this year's projected earnings per share, much lower than the price-earnings multiple of 15 for the Standard & Poor's 500-stock index. Toll Brothers has lost almost half its market value since its summer peak. The latest blow: On Feb. 7, Toll announced a 21% drop in the value of contracts for new homes signed in its first fiscal quarter, ended Jan. 31, compared with a year earlier. The stock fell \$1.73 to \$29.47.

The Street's distaste is understandable. Builders made huge profits when the value of the land they owned soared. But now, as the Arizona deal demonstrates, they're having to replenish their land banks at high prices. At the same time, housing demand and prices are moderating. On Feb. 7, the National Assn. of Realtors predicted that

WHAT GOES UP...
Realtors are predicting a drop in new-home sales

new-home sales would fall 8% this year from year's record, with construction work

fall 9.3%. Depressing the demand for homes is the inventory of unsold existing homes, which the Realtors group said is 26% higher in December than a year earlier. Goldman, Sachs & Co. economist Hatzis estimates that house prices eventually will have to stagnate for the next three to five years to correct an average overpricing of about 15%. David M. Rosenberg, chief North American economist at Merrill Lynch & Co., argues that housing probably peaked last summer. “The impact is starting to show through right about now,” he said in a Feb. 7 report.

Builders say what's happening is no more than a lull. They argue that they're better positioned for a market than in previous slumps, such as in the early 1980s, when many went bankrupt. They're less indebted. They build fewer homes on speculation. Much of the land they control is under option, so they don't have to buy it if they don't want to. In a conference call with analysts on Feb. 7, Robert Toll soundly mildly annoyed that investors aren't liking his company's optimistic story. He said Toll Brothers buys land such as the Arizona parcel with the intention of earning 25% to 30% a year on its investments.

If investors believed the company could really get that kind of return over the long term, the stock would be much higher. Instead, some are urging management to dial back. William Mack, an equity analyst for S&P, says Toll controls enough land to last

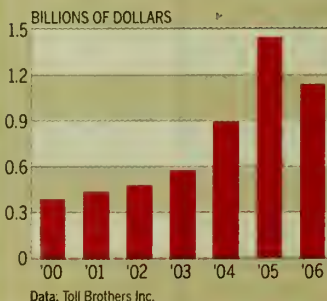
eight years at the projected 2006 rate of building. Instead of acquiring more land, he says, the company should buy back more shares.

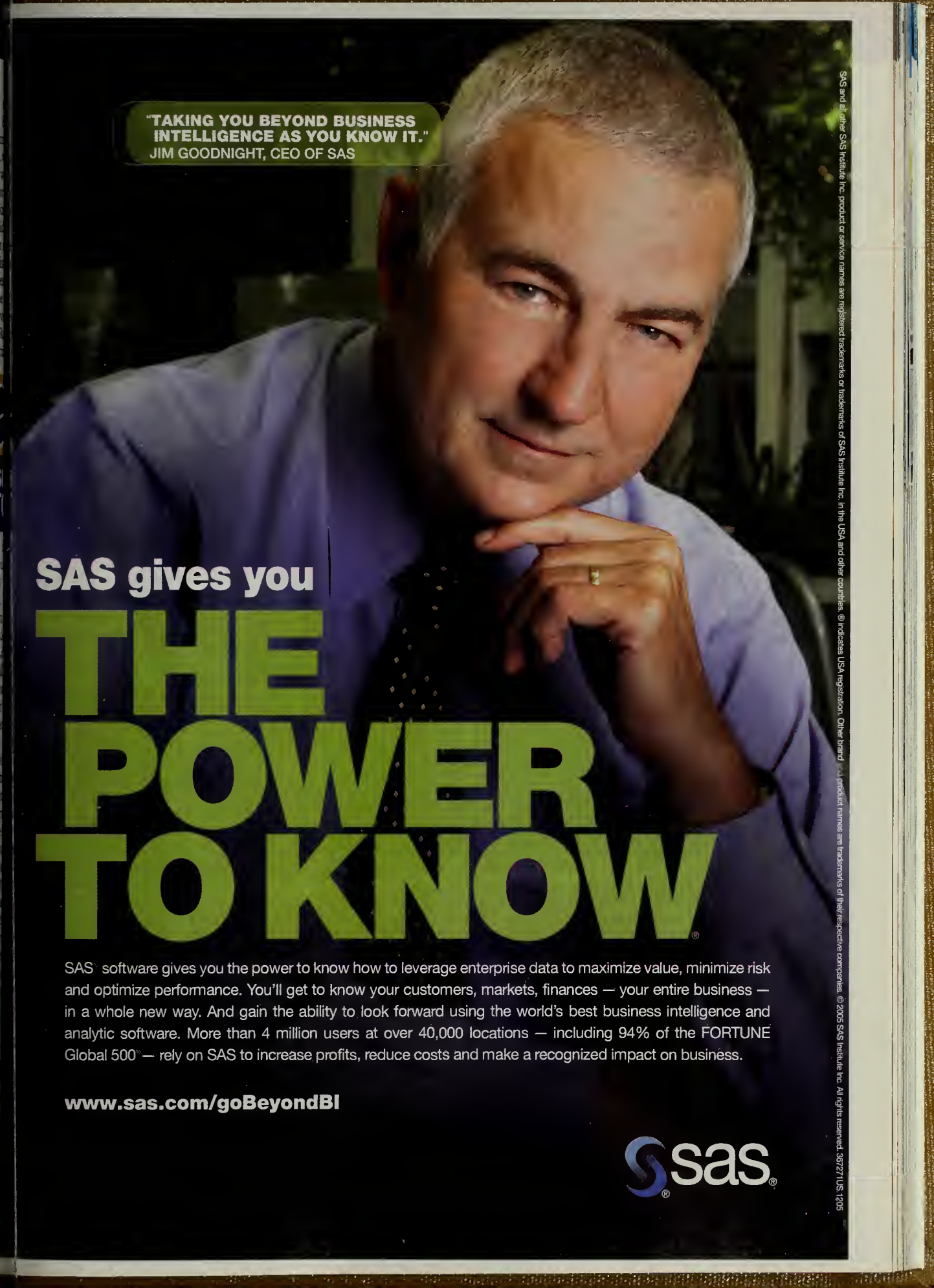
Builders like Toll have enjoyed huge profits, but business can dry up quickly if customers lose faith. The Arizona Proving Grounds, which cost-tested the endurance of Jeeps, may strain the stamina of homebuilders. ■



HOMEBUILDERS: A WARNING SIGN

Value of new contracts written by Toll Brothers in first quarter of fiscal year





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TELECOM

HOW RUPERT PLANS TO COUNTERPUNCH CABLE

Murdoch's DirecTV may team with rival EchoStar to provide Net and phone service

BY RONALD GROVER

RUPERT MURDOCH'S FLEET of satellites seem as if they're losing altitude. Profits were up at DirecTV Group Inc., the satellite operator of which Murdoch's News Corp. is the largest shareholder with a 34% stake. But the growth in the number of new subscribers—a measure of its future prospects—slowed by a third last year.

That hurts, especially after battling for years and spending \$6.8 billion to finally land his prize. The problem is that just as Murdoch took command, the satellite industry's soaring growth rate stalled as cable operators started winning back customers with all-inclusive monthly subscriptions that offer TV, broadband, and Internet phone service.

Now the 74-year-old Murdoch is gearing up to fight back. Hoping to team with his longtime archrival Charles W. Ergen, CEO of EchoStar Communications Corp., Murdoch is starting to put the pieces in place for a new \$1 billion wireless data and voice network. The idea is to offer the same bundle of services that cable companies and, increasingly, phone companies have been using to lure away customers. Says Murdoch: "Cable has it, and we think it would be very powerful for us to have it as well."

Although DirecTV CEO Chase Carey says the company is exploring several options, sources say Murdoch and Co. are close to finalizing a deal to create their own broadband network using the latest Wi-Max wireless technology. That may mean cutting a deal with a company such



as Clearwire Inc. or Sprint Nextel Corp. to get the wireless spectrum he needs to provide the service. Then he would have to lease cell towers to beam the spectrum over 10-mile-wide swaths to customers' newly modified satellite dishes. Once the

Slipping From A Stable Orbit

With no broadband service to offer customers, new satellite subscriber growth is slowing

DIRECT TV*	DISH NETWORK*
2004 1.8	2004 1.5
2005 EST 1.2	2005 EST 1.1

Data: Company reports, UBS Investment Research
*Millions of net new subscribers

signal enters the house, a wireless router designed with the help of Intel Co. would feed it to computers and phones. The box could also be used to beam programs to PCs, laptops, and portable devices for remote viewing.

As currently envisioned, the plan involves DirecTV and EchoStar creating a joint company, possibly acquiring technology providers. So far the two satellite outfits are testing the process with New York-based WiNetworks Inc., an Internet partner whose patented technology is being tried out in Germany to create a Max residential Internet service. Motorola

Corp., a Lincolnshire, Ill., business that handles the wireless data for UPS drivers and has holdings in companies that link satellite and land-based networks, is also a likely partner of the venture, says Investment Research analyst Aryeh Bourkoff.

Murdoch is throwing his counterpunch fast, beating the cable companies' siphon off even more of his satellite customers. He's already late to the broadband party. By 2008, he expects satellite broadband access to provide high-speed access to nearly 71% of Americans, according to Bourkoff. Increasingly, satellite is looking like an expensive alternative. Cable giant Comcast Corp., for instance, says it won 135,000 subscribers last year from satellite, thanks in part to its triple play for a month to new subscribers. True, a single package of EchoStar satellite service, voice, and data bundled by AT&T goes for about the same price. But that arrangement won't last forever as telcos begin offering their own TV programming via phone wires. Says Comcast President Stephen B. Burke: "The competitive dynamics with satellite shifts quite dramatically with the triple play."

Little wonder that Murdoch and EchoStar want to take control of their own future. Neither is afraid to slash prices to win subscribers, and they may have to. "It's like they have an option any longer," Jimmy Schaeffler, president of direct consultant Carmel Group. "This is a game about crisp pictures any longer. One knows that better than Murdoch."

—With Cliff Edwards in San Mateo, Calif.

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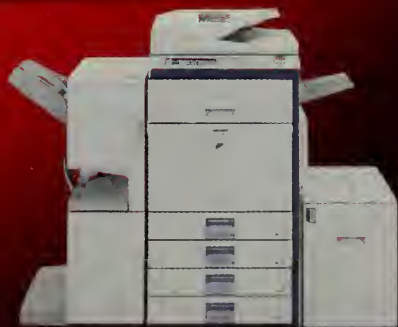


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COMMENTARY

BY JOHN CAREY

Skip Your Veggies? Not So Fast

A new study questions low-fat diets. The real story is more complicated

HERE COMES another wild ride on the roller coaster of health advice. For years we have been told that eating less fat and munching on more fruits and veggies can work magic, preventing everything from heart disease to cancer. Now a study of 48,835 women, part of the Women's Health Initiative, says that such "healthier" diets bring no benefits.

The study was published by the respected *Journal of the American Medical Assn.* (JAMA). But before you rush out for fast food, ask a few simple questions. What did the study actually examine? Do its data support such a sweeping conclusion? We often overreact to studies that are more limited and uncertain than we realize. One startling fact: Fully one-third of all dramatic new findings simply don't hold up in later studies. Remember hormone replacement therapy? Once presumed to cut heart disease risk, it was later found to be dangerous—and now doctors are questioning those supposed risks.

Among other things, the new diet report shows how research dollars can be won for questionable studies. In the early 1990s, when the study was proposed, prominent researchers such as Harvard's Dr. Walter Willett argued that it wasn't worth doing. Reviewers at the National Institutes of Health turned it down for funding. But Dr. Bernadine Healy, appointed as NIH director in 1991, lobbied relentlessly for support for the suite of studies that make up the Women's Health Initiative. "It was an end-run through Congress that got it approved," Willett recalls.

Based on its design, the trial had little chance of making major advances in the science of nutrition. It set out to compare women eating normal diets with women asked to eat less fat and more fruits and vegetables. But the two groups' diets really didn't differ all that much. Those with "healthier" diets cut calories from fat by only 8.2% compared with the normal group and ate only 1.1 additional servings of fruits and vegetables a



day. That's too small a difference to expect health benefits.

What's more, scientists now know that the type of fat we eat is generally more important than the amount. Monounsaturated fats, such as those in olive oil, or omega-3 fats found in fish, are healthier than saturated fat, as in butter or beef. Worst of all are so-called trans fats, which are created by adding hydrogen to natural fat. Trans fats are widely used in everything from margarine to cookies, and have been linked with increased risks of heart disease. By focusing just on total fat intake, the study missed a chance to tease out the effects of these different types of fat. "It's really important not to go away with the message that fats don't matter," says Willett.

There are larger lessons as well about how science works. The detailed methods of a study are crucial, and their limitations are often glossed over. When Dr. Steven Woloshin of Dartmouth Medical School looked at press releases trumpeting various scientific articles, "we found that 70% failed to mention the study's limitations," he says. And up to half of all articles exaggerated the actual benefit or risk being studied.

The type of fat we eat is more important than the amount

One common distortion is to present the effects of a treatment intervention in relative terms, such as saying that a particular diet would cut the death rate in half. That

sounds huge, but it might mean that there was only one death per million people instead of two, which is a reduction in actual risk that's too small to matter. All this helps explain why science so often seems to be flip-flopping. And there's no mystery about why results are often exaggerated: Researchers, medical centers, and scientific journals are all competing for funds and publicity, just like everyone else.

The truth is, science is often less definitive than people think. Even when a study does find a clear benefit or danger, the results may not be applicable to the real world, where people have more complicated health issues and medicine isn't so black and white. There's a long list of treatments and medical interventions, from bypass operations to back surgery, where the benefits may not be as great as once thought. What does this mean for diet? "We don't want to be morbidly obese or too skinny," says Dr. Nortin Hadler, professor of medicine at the University of North Carolina at Chapel Hill, "and it's pretty compelling that between those two extremes, we can't measure many differences." So try to stay fit, keep your weight down, aim for a relatively healthy diet, and don't worry too much about the latest headlines in the medical journals. ■

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RUSSIA

SHOPPERS GONE WILD

Russian consumers are on a buying spree. That's great news for multinationals across the globe

BY JASON BUSH

IT'S MIDDAY ON SATURDAY, AND the Mega-1 mall in southern Moscow is packed. Shoppers have come to stock up on groceries at the mall's French-owned Auchan hypermarket, buy furniture at Swedish retailer IKEA, and browse dozens of boutiques selling everything from Yves Rocher cosmetics to Calvin Klein underwear. Although crammed with expensive Western merchandise, Mega has been a hit since it opened its doors in December, 2002. Last year it was the world's most frequented shopping center, with 52 million visitors.

Down the road at the Rolf car dealership, Oxana Starostina is filling in registration forms for her new Mitsubishi Lancer, purchased with \$20,000 in cash. She and her husband, Maxim, saved the money from their small construction supply business. "Living standards are improving. If you are young or middle-aged and earn \$1,000 a month, then you can afford to buy a new car," she explains. Last year the dealership earned an award for being the world's best-selling Mitsubishi outlet. On an average day in 2005, Rolf sold 15 to 20 Mitsubishi Corp. and Hyundai Motor Co. autos costing \$15,000 to \$60,000. These aren't the only carmakers prospering. Last year, Ford Motor Co.'s sales in Russia increased an impressive 54%. Ford now has more than 11% of the Russian car market after launching local production of its flagship Ford Focus in 2002.

When most investors think of Russia, they think energy—the fall of Yukos, the rise of Gazprom, and the muscular petropolitics of the Kremlin. But for many multinationals from the U.S., Europe, and Asia, the consumer boom, not oil and gas,

is the investment story to watch. Last year, Russia drew a record \$16.7 billion in foreign direct investment, 38% more than in 2004. Consumer-related sectors attracted the lion's share. Big deals included Coca-Cola Co.'s \$600 million acquisition of Russian fruit-juice maker Multon, \$750 million in acquisitions by Dutch brewer Heineken, and investments in car production from the likes of Toyota and Volkswagen.

What's attracting these companies is the surprising strength of the Russian consumer, not just in Moscow but also,

increasingly, in other cities catching with the capital's breakneck economic development. Russia's gross domestic product grew by 6.4% last year and has a aged 7% growth over the past five years. Dollar income per capita has risen nearly 29% per annum over the same period, faster even than in China.

AN EXPLOSION

RIISING DISPOSABLE INCOME and growing middle class have caused an explosion in all types of consumption. Last year, sales of new foreign cars reached

600,000, a 57% increase on 2001 and a sixfold rise since 2001. Mobile-phone ownership has mushroomed from 3 million in 2001 to 80 million today. No less than one-fifth of all households own a computer, four times the figure in 2001. "The most striking thing is the overall growth of consumption potential. It's shown by literally all measures," says Alexander Doudov, managing director of Rus market research in Moscow.

What makes the buying spree all the more remarkable is that the average income per person, which is growing fast, is still just \$3,000 a month. Yet a surprising number of Russians live as well or better than their Western counterparts. The richest tenth of Russia's population earns around 15 times as much as the poorest tenth. At the end of 2004, Russia had an estimated 88,000 millionaires, according to a study carried out by Merrill Lynch & Co. and Capgemini. And it's not just the millionaires who are buying cars at the Rolf dealership. Russia's largest foreign-car importer and distributor, says President Matt Donnelly. He estimates



More Russians Are In the Rubles

OWNERSHIP BY SHARE OF HOUSEHOLDS

	2001	2005
Mobile phone	6%	50%
Computer	5	20
Washing machine	16	35
Stereo	15	31
Video recorder	39	50
Car	25	31
Imported TV	58	71
Apartment or house	71	82

*August, 2001 vs. August, 2005

Data: GfK Rus



PING OUT
Prada has
ed a boutique
Moscow

8 million Russians earn at least \$200 a month, and 3.5 million earn more than that. "It doesn't sound like a lot, but they have masses to spend," he adds. "That's because some 70% of Russians' income is disposable, vs. around 40% for a typical Western consumer. "We have a 13% flat income tax, subsidized housing and utilities, and 10% savings. The rest of the money is pretty much out there being spent," says Natalia Zagvozdina, a consumer-analyst at Moscow investment bank Renaissance Capital.

HST FOR JOE

NO ONE SHOULD underestimate the growing potential of Russia's wider market, either. Multinational food and consumer companies, the biggest consumer-goods investors in Russia, have already discovered that mass-market opportunity. "As soon as people step out of poverty, they become potential Nestlé customers," says Bernard Meunier, country manager for the Swiss food giant, which has pumped \$500 million into Russia to build Nestlé's most recent foray, a \$120 million instant-coffee factory that opened in Krasnodar, in southern Russia, last November, was its first international greenfield investment for two decades. Why there? With an average of 250 cups per

person per year, Russia consumes more instant coffee than any other country.

Russians' thirst for joe is a sign that the consumption boom is driven as much by changing tastes and lifestyles as by rising incomes. Prior to the 1990s, Russians barely touched the stuff, preferring tea. Beer is a similar case. Beer consumption has risen from 15 liters a head in 1995 to 60 liters in 2005, just a few liters shy of the European average. Rapid growth has lifted profits for companies such as Denmark's Carlsberg, which owns 50% of leading Russian brewer Baltic Beverages Holdings.

Analysts calculate that there's still plenty of potential for growth in fields such as tourism and financial services as well as consumer durables like automobiles, furniture, and electronics. Appliances giant Whirlpool Corp. is planning to make washing machines in Russia, in partnership with Turkey's Vestel Group. American Express Co. launched its first ruble credit cards in December, working in partnership with Russian Standard Bank. "This is a market for the future, and we think it's got real opportunity," says

American Express Executive Vice-President Gary L. Crittenden.

There are still openings for relative latecomers to the market, too. "The results are far better than even our most optimistic forecasts," says Leszek Krecielewski, country manager for Ada (Mich.) direct-sales giant Amway Corp., which began selling cosmetics and detergents in Russia last March. Sales reached \$110 million in nine months, above forecasts of \$100 million for the first year, and were a big chunk of Amway's \$600 million in European sales in 2005. The company projects Russian sales will rise to \$200 million this year.

Will the consumer boom last? Russia's economy remains closely tied to global oil prices and could face an upset if prices plunge. Then again, persistently high oil prices mean economists are raising their forecasts of Russians' future income and consumption. Goldman, Sachs & Co. predicts Russia will be the world's eighth-largest economy by 2025, with per capita income of \$45,000. China and India are hot. But Russia is heating up fast, too. ■

**In Russia,
70% of all
income is
disposable,
vs. 40% in
the West**

CONSUMER ELECTRONICS

THIS PLAYSTATION MAY PLAY TOO MUCH

Sony's new PS3 handles a lot more than games. That could confuse buyers

BY KENJI HALL

PICTURE THIS: YOU PLUG your TV into a box the size of a phone book and go online to check headlines. You get bored and click over to a Giants game. Later you download *Casablanca*, play *Metal Gear Solid* against an opponent in Seoul, then chat with a friend in Seattle. What sort of box is this? It could be a PC, but Sony Corp. hopes it will be a PlayStation 3, the video game console it plans to introduce this spring.

Six years in the making, the PS3 is a crucial component of Sony's strategy to dominate the digital home with a full lineup of super-sharp TVs and other gear. To attract teens and parents alike, the console plays high-definition games and movies from Blu-ray DVDs. It boasts a huge hard disk to store photos, music, and TV shows. And it can connect to the Net for play against far-flung rivals, while a new multimedia chip called "the Cell"—developed by Sony, IBM, and Toshiba at a cost of \$400 million—juggles the workload.

If that seems like a lot to pack in, it is. But there's a lot at stake. Sony is banking on the console to lift its consumer-electronics division out of trouble, and the Blu-ray drive is expected to give a boost to that Sony-backed format, one of two competing to become the next-generation standard for videos. "PS3 is very important for us," says Sony Chief Financial Officer Nobuyuki Oneda. "There are so many key devices from the electronics group that will go into it."

Some question whether Sony is trying to cram too

much into the new box. The PS3 is expected to cost \$350 to \$400. While it has the potential to be a megahit, Sony's message might get muddled in the process of going after too broad a market, says Deutsche Securities Ltd. analyst Takashi Oya. "It would be difficult to sell PS3 initially as anything other than a game machine," Oya says. Sony declined to comment on such concerns.

Spearheading the PS3 assault is Ken Kutaragi. The 55-year-old former engineer heads the game division and is the mastermind behind the smash-hit PlayStation and PlayStation 2 machines, which have made Sony an unstoppable force in the industry. Last year the game unit earned \$365 million and accounted for roughly 38% of Sony's operating profit, compared with a \$290 million loss at the electronics division.

But Kutaragi's Mida touch has let him

down before, especially when it comes creating multipurpose machines. Exh. A: the PSX. Released in Japan in 2000, it was designed to appeal to a broader audience than the hard-core gamers attracted to the PS2. It comes with a 250-gigabyte hard drive and a simple Web browser and plays games, movies, and music. But the PSX bombed as consumers were confused by the hybrid and put off by its \$800-plus price tag. "If Sony wants PS3 to be a hit, it has to avoid the marketing mistakes made on PSX," says Reiji Asakura, author of *Revolutionaries at Sony*, a book about the development of the PlayStation.

Another risk is that Sony could undermine software sales by positioning PS3 as something other than a game machine. The company makes the bulk of its game profits not from consoles but from PC games, which can cost \$50 or more. Even when Sony doesn't design the games, it picks up royalties from each sale.

FEWER GAMES

IF CONSUMERS BUY the PS3 as a multimedia machine, they might not purchase as many video games. Sony ought to know: The handheld PlayStation Portable (PSP) has been a success since its debut in December, 2004. But since the PSP also plays music and movies,

fewer people are buying games designed for it. In the PS2's final year on the market, more than three games were shipped for each machine that shipped. For the PSP, that ratio slipped to 2 to 1.

Sony hasn't set a launch date, but analysts expect the PS3 to be released in Japan in June and hit U.S. stores in time for Christmas. With its features, the console might indeed help Sony in its battle to become the living room rival to the digital entertainment hubs. Unless, of course, all consumers really want is a simple game machine. ■

—With

Edwards in
Mateo, Calif.,
Ronald Groves
Los Angeles

Meet the PS3

Sony's latest game console will offer a host of new features:

- » Superfast multimedia chip
- » High-definition video player
- » Broadband link for movie and game downloads and play against far-flung opponents



CROSSOVER DREAMS

Kutaragi hopes the PS3 will boost Sony's Blu-ray video standard



MERCEDES E-320 Will 'BlueTec Inside' win over Americans?

MAKERS

DIESEL GETS CLEANER AND GREENER

Daimler's new engine beats hybrids for top and fuel efficiency, but it's not cheap

BY JAIL EDMONDSON

For years diesel engines have been the rage in Europe. They're powerful, use relatively cheap fuel, and can propel a car 40 miles on a single gallon. But they've never really caught on in the U.S. where memories of 1970s-era soot-belching diesel cars still linger. Now, DaimlerChrysler is trying to clear away that old image. The company has engineered a new emissions technology that promises to make diesel as clean-burning as gasoline. Daimler also has just announced plans to unveil its clean-diesel exhaust system in the U.S. in the latest Mercedes E-class sedans. Daimler's system, called BlueTec, uses a catalytic converter and specialized filters to reduce harmful nitrogen-oxide emissions. The company is betting BlueTec will turn U.S. drivers on to diesel and give hybrids fresh competition. The reason: Mercedes clean-diesel cars will cost less than an equivalent hybrid while offering greater power and acceleration, plus up to 40% better mileage over conventional gas engines. That's a lure for Americans who

love big cars and off-road vehicles. And diesels can go 500 miles without a fill-up.

Diesel has floundered in the U.S. because oil companies haven't offered the clean fuel required in Europe. Since diesel pollutes more than regular gas in the U.S., such big markets as California and New York refuse to register new diesel cars. Later this year, though, the feds will require oil companies to switch to the low-sulfur diesel long available in Europe, eliminating the soot problem.

But Daimler's exhaust-treatment technology will go a big step further, cleaning up to 80% of the remaining nitrogen-oxide emissions. That, combined with good mileage, will make diesel a truly green U.S. driving alternative for the first time. DaimlerChrysler CEO Dieter Zetsche likens Mercedes' emissions-control solution to Silicon Valley tech breakthroughs. "It's our intention that customers regard BlueTec for diesels [as] similar to

'Intel Inside' for PCs," says Zetsche.

That sounds like a stretch. But many industry experts believe a new generation of clean-diesel cars will eventually win over Americans and that diesel will become the dominant technology for fuel-efficient autos. While hybrids get better mileage only in the city, diesel cars consume less fuel in all driving conditions. Market researcher J.D. Power & Associates (like *BusinessWeek*, a unit of The McGraw-Hill Companies) forecasts diesel will take 11.8% of the U.S. market by 2015, up from about 3% now. Says Anthony Pratt, a senior J.D. Power analyst: "We think it will fly, and the Europeans have the most to gain."

Daimler isn't the only one to recognize the opportunity. Volkswagen, which is working on two different clean-diesel technologies, saw its U.S. diesel sales double in 2005, to 25% of total sales. It already sells Jetta, Golf, and Beetle diesel models in the U.S. The first VW clean-diesel model will be a Touareg SUV, slated to launch this year. BMW and Audi also have plans for diesels, as do Nissan and Honda. If the Japanese mass marketers put their muscle behind diesel, it will suddenly have much broader appeal.

USER-FRIENDLY PUMPS

DAIMLER, WHICH ALSO intends to put BlueTec into Chryslers, appears to have an early jump, but hurdles remain. Perhaps the biggest: Oil companies need to update their filling stations with modern, user-

friendly pumps for passenger cars. And some diesel critics note that the cost of the equipment to clean up diesel's emissions will bring the premium for clean-diesel cars close to that of a hybrid, especially in smaller models.

Mercedes insists that the premium over a gasoline E-Class will be less than \$2,000, compared with at least \$4,000 for a hybrid. Even that added

cost could be partially offset if the U.S. government proceeds with plans to offer diesel the same tax benefits hybrids now enjoy. Toyota Motor Corp. may have stolen the limelight on fuel efficiency with its hybrid Prius. But if the new crop of Daimler clean diesels catches on, the real debate about green car technology may be just beginning. ■

—With bureau reports

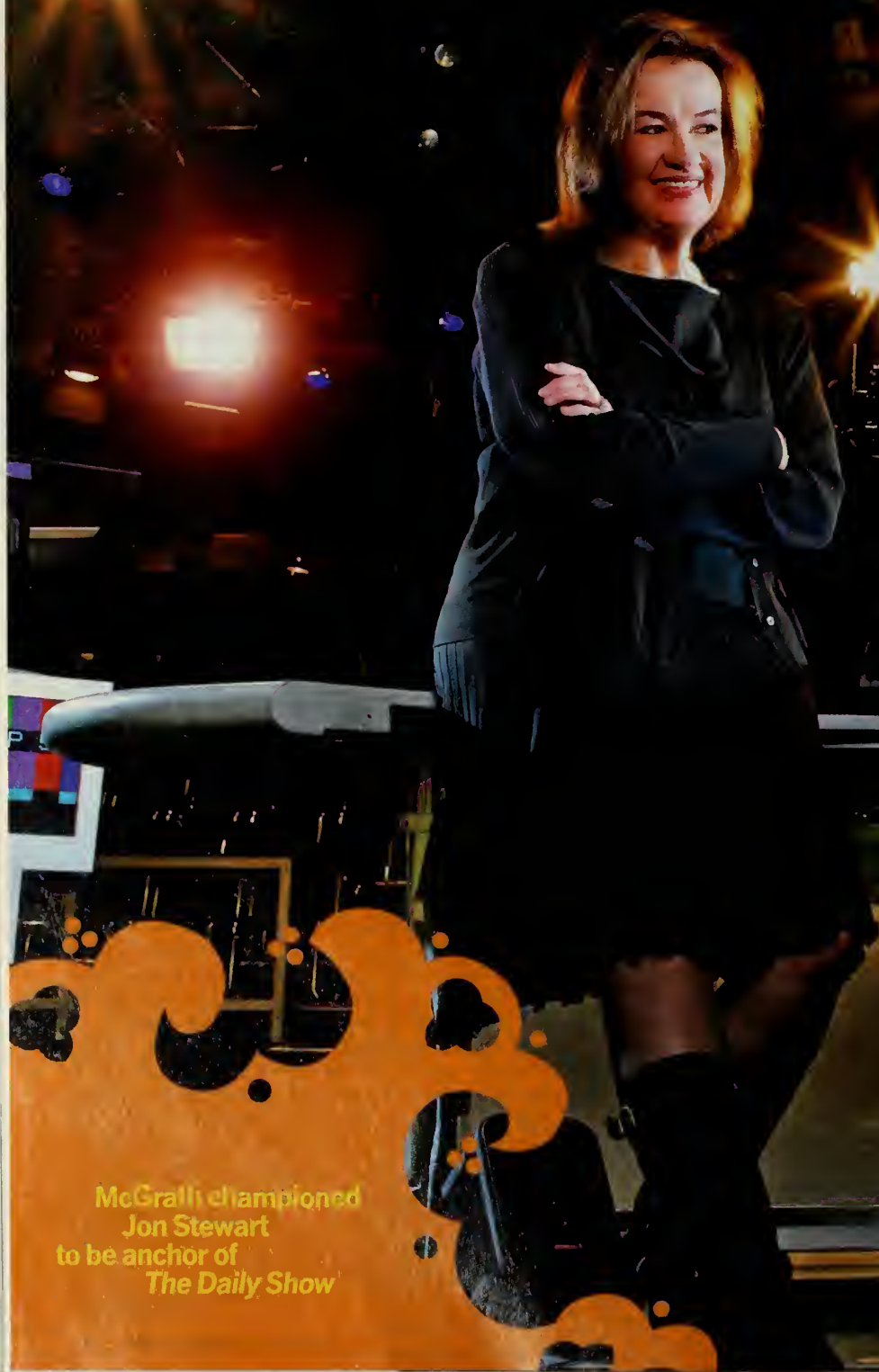
THE STAT

40%

Maximum improved mileage of diesel over gas engines

Data: J.D. Power & Associates

COVER STORY



McGrall championed
Jon Stewart
to be anchor of
The Daily Show

can MTV stay cool?

How CEO Judy McGrath
must remake her
TV empire for a
digital world
by Tom Lowry



PHOTOGRAPH BY BRAD TRENT; GRAPHIC BY LAUREL DAUNIS-ALLEN/BW

Nearly 40 years ago, in a blue-collar Irish neighborhood in Scranton, Pa., Judy McGrath fell in love with music. As much as her father, Charles, tried to get his only child to listen to Duke Ellington on the family hi-fi, she preferred the Rolling Stones, and later, Neil Young. Her mother, Ann, read *The Catcher in the Rye* to her when she was seven and explained to

Judy that the nuns at her Catholic grade school weren't always right: She could have an opinion, too. It was in this progressive environment in the McGraths' small house on Orchard Street that Judy began to imagine a life beyond Scranton, in New York. "It felt like a land far, far away," she recalls. "I'd never been to New York City until I came here looking for a job. It felt impossible, like there was a sense of a tribe, of people I wanted to be part of. So I had this idea that I could write about music. That would be the ideal job for me." She eventually set her sights on *Rolling Stone*, that pinnacle of pop culture in the late 1960s.

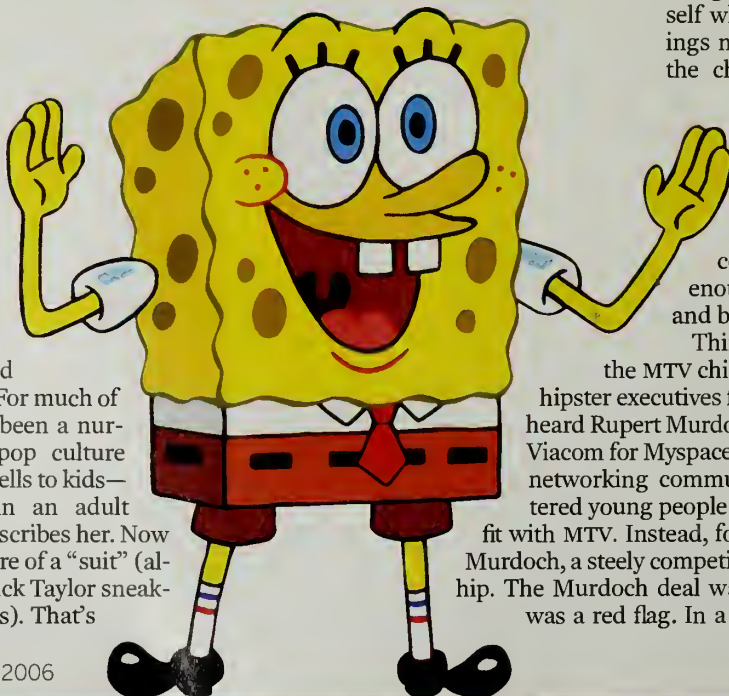
McGrath made it to New York, but never to her favorite magazine. Her life instead took a magical detour that led her to write on-air promotions for a new invention, music television. Twenty-five years later, at 53, she is chairman and CEO of MTV Networks Co. The \$7 billion-a-year operation she oversees is a collection of some of the most recognizable brands in the business, from the original MTV to Nickelodeon to VH1 to Comedy Central. Their programs are seen in 169 countries and heard in 28 languages. Under her management are such youth icons as SpongeBob SquarePants, the *South Park* runts, and comedian Jon Stewart. At night she might be out listening to a new band or at home trolling skateboarding blogs. Or she might be dining with REM singer Michael Stipe. In the past year, Bono has given shout-outs to McGrath at sold-out U2 concerts thanking her for MTV's support of his AIDS and antipoverty campaign. And in a funny twist, she and *Rolling Stone* founder and publisher Jann S. Wenner, whose writers she idolized, are good pals.

It's a long way from Scranton. Today the girl with a bohemian streak and rock 'n' roll dreams has one of the biggest and most challenging jobs in media. For much of her time at MTV, McGrath has been a nurturing manager of talent, a pop culture maven with a keen eye for what sells to kids—a "16-year-old boy trapped in an adult woman's body," as one friend describes her. Now she'll be less a "creative" and more of a "suit" (albeit accessorized with black Chuck Taylor sneakers and Urban Outfitters T-shirts). That's

because Viacom split in two at the beginning of the year, putting MTV and McGrath fully into the public eye. CBS went off as a separate company, leaving the new Viacom Inc. comprised of Black Entertainment Television, the Paramount Pictures Co. studios, and MTV Networks, which accounts for 85% of all operating profits. What was a longtime partnership between McGrath and No. 1 executive Tom Freston is now a solo Freston having ascended to the CEO job for all of Viacom. Freston, 60, jokes that his relationship with McGrath is most enduring he's ever had with a woman. After all, they dated MTV with folks like Robert W. Pittman, who went on to a rocky stint as a honcho at AOL Time Warner. Their wildly successful convergence play of 25 years ago put music and video improbably together and changed cable TV and music forever.

When the McGraths dropped their daughter off in New York in 1978 with no job prospects, they assured Judy, then 26 and armed with an English lit degree, that she would land on her feet. Soon she was writing stories for *Mademoiselle* with titles like "Models' Party Tips" and "Men Who Love Women V Hate Men and Why." Like so many young people who come to New York teeming with ambition, McGrath found that life in the big city was the "ultimate high," she recalls, no matter how lean she was living—in this case crammed into a Gramercy Park apartment with seven other women. Three years later she was doing the "Dos and Don'ts" advice column for *Glamour* when friends, impressed with her turns of phrase, recommended her to Pittman. He hired McGrath to write promos for MTV, giving her a distinctive voice right out of the gate. To McGrath takes on her new role as the very notions of hip and cutting-edge are being reinvented once again. You might say her challenge is much as it was on her first job: to make a unique amid the media clutter.

The empire McGrath oversees is rich in youth-icon gold mines like SpongeBob SquarePants



The music channel may have seemed bold and experimental when it began in August, 1981. But the MTV empire today is a staple of the media Establishment and faces a slew of threats. After all, it's the iPod in a broadband world, and the new generation is defining for itself what is edgy and new. Young things may be strong for many of the channels, but the original MTV isn't the must-see channel it was. "We watch it because it's there," says Marie McGrory, a Manhattan 10th grader. McGrath keeps her cool enough and nimble enough for Marie's generation and beyond?

Think about the cold war between the MTV chief and her coterie of aging hipster executives felt last summer when Rupert Murdoch had outbid MTV parent Viacom for Myspace.com. The exploding social networking community of 54 million registered young people would have been a perfect fit with MTV. Instead, for \$580 million, it went to Murdoch, a steely competitor but hardly an arbitrageur. The Murdoch deal was no mere acquisition; it was a red flag. In a rare stern message to



Way More Than a Music Channel

Launched in 1981 as a music video channel, MTV Networks today comprises a slew of channels, Web services, and wireless services to keep everyone from toddlers to boomers tuning in. All together, the billion-dollar company reaches 440 million households in 169 countries. Some of the channels:

NETWORK	TARGET AUDIENCE	HITS	CHALLENGES
MTV	Preschoolers, 2-5 years old	<i>Jack's Big Music Show</i> , <i>64 Zoo Lane</i> , <i>Connie the Cow</i> , and <i>Miffy</i>	Competing with PBS Kids Sprout channel, a partnership with Comcast.
MTV2	Grade school kids, 2-11 years old	<i>SpongeBob SquarePants</i> , <i>Jimmy Neutron</i> , and <i>Dora the Explorer</i>	Making a go of new acquisitions, Neopets and GoCityKids.com, and building an audience for new broadband channel TurboNick.
MTV3	Teenagers, young adults, 12-34 years old	<i>Laguna Beach</i> , <i>Real World/Road Rules</i> , <i>TRL</i> , and broadband outlet <i>OverDrive</i>	Building franchise shows beyond reality TV and winning back team loyalty; selling music on its new download service, URGE.
MTV4	All ages, including boomers, 18 and up	<i>Celebreality</i> , <i>Hip Hop Honors</i> , <i>Breaking Bonaduce</i> , <i>The Osbournes</i> , and broadband channel Vspot	How much celebrity is too much in the celebrity-saturated universe?
MTV5	Guys, 18-49 years old	<i>CSI</i> reruns, <i>Ultimate Fighting Champions</i> , <i>Video Game Awards</i>	Getting ratings for new show about regular guys competing with pro jocks, <i>Pros v. Joes</i> , and new dramatic series <i>Blade</i> .
MTV6	Laugh junkies, 18-49 years old	<i>The Daily Show with Jon Stewart</i> , <i>The Colbert Report</i> , and <i>South Park</i>	Filling the void left by Dave Chappelle, who quit his show unexpectedly last year.
MTV7	Gays, lesbians, and the curious, 18-49 years old	<i>Noah's Arc</i> , about four black gay men in Los Angeles, and <i>Curl Girls</i> , about lesbian surfers	Persuading more cable and satellite operators to carry the channel. It's now in 22 million homes.
MTV8	The nostalgic, 18-49 years old	Reruns of classics: <i>I Love Lucy</i> , <i>Green Acres</i> , <i>Good Times</i> , etc.	Developing more shows like last year's <i>Chasing Farrah</i> .
MTV9	Country fans, 25-54 years old	<i>Miss America Pageant</i> , <i>Country Music Awards</i>	How about some scripted programming?

Data: BW

senior staff, according to one executive present, McGrath warned that MTV could no longer afford to miss opportunities like myspace. Not when old business models were blowing up and every week brought a new outlet for doing what MTV had done so well for years—capturing the niche.

So McGrath has declared “a digital Marshall Plan.” It signals the end of the one-screen company. The troops must now deliver services across new broadband channels, over cell phones, and via video games. Because MTV is so tapped into its consumers—“we’re more inside the heads of our audience than anybody else”—advertisers will stay with MTV, she insists. McGrath is willing to shake things up, too. At a company known for nurturing homegrown talent, she broke the mold last November and tapped media consultant Michael J. Wolf to be president and chief operating officer. She added the post of chief digital officer the same month. Nostalgia for the era when *Video Killed the Radio Star* (MTV’s first music video), she says, is a distraction. “Nobody wants to be who they used to be, including us. Media identities, like market share, are up for grabs,” McGrath told a gathering of her advertising and affiliate sales executives in Miami in early January. “If we were launching today, the first song I’d tee up would be the [1980s band] Plimsouls’ *Everywhere at Once*.”

HOWDY, PARTNER

NO PIECE OF THE NETWORK is under as much fire as the core MTV channels. Its younger audiences are the most easily lured away in this age of do-it-yourself music mixes, podcasting, and streaming video. MTV’s ratings growth was just 5% over the past three years, according to research outfit Bernstein & Co., while VH1, with an older, more loyal audience, grew 17%. Comedy Central pulled in 10% gains, largely because of Stewart. Meanwhile, Nickelodeon’s \$1 billion in annual operating profits is fueled by sales of things like SpongeBob trinkets and Dora the Explorer dolls. “MTV turns 25 this year,” says Peter Golder, an associate professor of marketing at New York University’s Stern School of Business. “It’s difficult to be a mature brand.”

So McGrath is doing something alien to the start-from-scratch culture: seeking acquisitions and partnerships. MTV Networks last year bought companies like amateur short-film Web site IFILM Corp. and children’s Web site Neopets, treasure troves with tens of millions of sticky users. IFILM just launched a show on VH1, and the Nickelodeon team is helping to design consumer products for Neopets. In January, McGrath announced a deal in which MTV is teaming with Microsoft Corp.



MTV outsider Wolf was tapped by McGrath to be president and COO

to launch a music download service, later this year. Other forms of media are getting infusions, too, including movie units at MTV (*Hustle & Flow*, *derball*) and Nickelodeon (Julia Roberts’ *Charlotte’s Web*, due out this year).

And never mind the cultural wars: McGrath continues to break new ground with channels such as gay-and-lesbian-themed Logo, which so far is seen in 22 million homes, despite pushback from some distributors.

For McGrath, the networking never ceases. Her schedule the week of the Grammy Awards in Los Angeles goes like this: a meeting with IFILM CEO Blair Harrison to discuss new projects (she decided to pass up the gala and give him her ticket the better to smooth the new relationship); a sitdown with Jeffrey Katzenberg of DreamWorks Animation SKG Inc., whose live-action movie business was sold to MTV’s sister company Paramount; a tour of the studio’s operations and discussion

right on

get serious

...a possible rollout of consumer products with Dream-
...; lunch with Jared Hess, director of the 2004 indie smash
...on *Dynamite*, to see if he might do some short-form work
...TV. Then a quick flight to Vail by week's end to meet with
...distributors during a ski outing.

...he readies MTV for its changing game, McGrath finds

...a member of the small
...owing club of women at
...p of big media compa-
...oining Oprah, Martha,
...Disney Co.'s Anne
...ey, and a handful of oth-
...ble TV was supposed to
...re open to new leader-
...et the path to the execu-
...ite is still plenty steep.

...h remembers
...thrilled to attend
...st industry lunch
...York's 21 Club in
...arly 1980s. But
...n she entered, she

...,"some guy handed me his
...check." As it turns out, Mc-
...gets much of the credit for
...ing MTV's inclusive culture,
...better for risk-taking and

...ity. "There is less
...erone. It's not the
...st of the old Holly-
...moguls where
...ey are throwing
...at each other,"

...ttman. "It's about listening
...cepting ideas wherever and
...er they come from."

...The diverse staff of fashion-
...rd twentysomethings—
...n of those colors-of-the-world
...en on ads—rushing urgently

...pacs through the halls of MTV, McGrath just blends in. She
...ear designer suits, true, but she can hold her own with a
...onil of hip-hoppers. She tries to go home most nights at a
...lately sane hour to her daughter, Anna, 11, and her husband
...ay-at-home dad, Michael Corbett, but she always lugs a
...g of scripts and tapes. After Anna's asleep, she peppers ex-
...utes with Blackberry messages well past midnight.

At the receiving end of those messages is often her new
deputy, Wolf. The new president, 44, is everything she isn't: left-
brained, slightly academic, a bit stiff in new jeans donned for
his job as grownup at the MTV party. Over a 20-year career at
Booz Allen Hamilton Inc. and McKinsey & Co., Wolf has looked
under the hood of nearly every major media outfit, although he

never had a hands-on role.
Wolf has a reputation as a
brilliant strategist with an
invaluable Rolodex, having
helped dozens of CEOs
navigate through the
shoals of new media. He
and McGrath met nearly 10
years ago, when MTV be-
came a client.

Wolf's biggest brief is to
capture new digital dollars. Cur-
rent online revenue is about \$150
million, projected to grow to \$500
million in three years. "Listen, the
world has come to us,"
says Wolf. "The Inter-
net is no longer about
text. It's about video.
We produce and own
more video than any-
body." On any given

day, he and his boss fuel up on
Starbucks, sit on the big sofas in
McGrath's office, and plot how to
reengineer MTV. They might ana-
lyze the 30 to 40 poten-
tial deals on his desk. Or
he'll recount his talks
with advertisers. Right
now, Wolf is crafting a
plan with Honda Motor
Co. to market cars to
younger buyers across

all MTV platforms. (Advertising brings in 60% of MTV re-
venues; distribution fees, 30%; consumer products, 10%.) "Ad-
vertisers would rather connect with that one alpha consumer
[young trendsetter] vs. three beta consumers," he says. "We un-
derstand that audience, and we can help them do that."

His team is wielding the network's consumer research to win
deals, for example, with the makers of must-have gadgets. Stud-

PLAYBOOK: BEST-PRACTICE IDEAS

Keepin' it Real

McGrath is known for her skillful management of
talent and the chaos that comes with a creative
enterprise. A few items from the McGrath bible:

➡ **Listen to all your people** McGrath hates it
when staffers pander and say: "This is what Judy would want." Tune
in to everyone, from interns to senior VPs, then offer advice. "Judy's
ability to concentrate on people" is intense, says one MTV exec.

➡ **Make change part of your DNA**
"A couple of years ago, Bono said U2 was 'reapplying for the title of the
world's greatest rock band.' For all their success, they took nothing for
granted. They 'reapplied,' which is how they stay sharp."

➡ **Companies don't innovate, people do**
"We can't pat ourselves on the back too much. Stephen Hillenburg, a
former marine biology teacher, not a committee, was tired of looking
at animation of dogs and cats and thought: 'Why not a sponge?'"

➡ **Use research as a tool for creativity**
"Some say focus groups kill the creative spark. That doesn't have to
be. We say to our best people: 'Hey, a lot of kids seem to be watching
TV at the same time they're playing video games.' We feed our
creatives the info and let them make something out of it."

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this week's Cover Story at businessweek.com/coverstory.



ies done for Nickelodeon recently found that kids aged 8 to 14 send an average of 14.4 text messages and make 8.8 calls on their cell phones a day. Executives at SBC Communications Inc., now AT&T Inc., were fascinated by these findings and have begun working with the kids' channel to develop a phone and services for preteens, says McGrath. Jason Hirschhorn, MTV's chief digital officer, is talking to everyone from Verizon Communications Inc. to Best Buy Co. about using MTV shows and characters. "Consumer electronics are the new Nikes," says Hirschhorn, 34. "Kids want their phones or their MP3 players to say something about who they are." So MTV helped Virgin Mobile Holdings and handset maker Kyocera Corp. design a new slider phone.

Reviewing the arc of any career, there's always a sense of inevitability. But serendipity played a big part in Judy McGrath's path to MTV. In 1980, Bob Pittman was an executive at Warner Amex Satellite Entertainment, a company that owned The Movie Channel and a few other media properties. His mission was to put music on cable TV. Pittman's then-wife, Sandy, worked at *Mademoiselle* and suggested a few colleagues her husband might want to hire. First he recruited Ann Foley, McGrath's friend and today an executive vice-president of programming at Showtime Networks Inc. (part of the CBS side in the Viacom split). Then he hired Brown Johnson, who runs the Nick Jr. brand today under McGrath. A year later, Johnson and Foley sent him Judy.

As much as MTV shaped her, McGrath brought to her job a strong sense of community. If she has been "smart or lucky at one thing," McGrath says, "it has been [picking] good people." She attributes much of that to her parents' "everyman sensibil-

MTV, Pixelated

In the past six months, MTV has hired a chief digital officer and restructured the company for the new media world. Some of MTV's moves on the convergence front:

Online communities It acquired Neopets, an online kids' network with 25 million members; IFILM, where amateur filmmakers can show their short form stuff; GameTrailers.com, a site for video gamers; and GoCityKids.com, for kid-friendly activities.

Broadband There are five broadband channels: Overdrive (MTV), TurboNick (Nickelodeon), Vspot (VH1), Motherload (Comedy Central), and mtvU Über (mtvU)—with more in the works.

Download URGE, a music service, will launch later this year in partnership with Microsoft that will include exclusive MTV programs.

Wireless MTV has 57 wireless deals worldwide reaching 750 million cell phone users. It announced a deal in December with Amp'd Mobile, showing programs from all of MTV's channels.

Video on Demand It has agreements with Comcast and Charter to deliver on-demand programs from its channels.

Games MTV Games was started in June, a division created to launch new video game titles. Midway Games is a partner.

ity." Ann and Charles Grath died on the same four years apart in 1980s. "They never got to see or enjoy the ri says McGrath. "But they the reason I had an excel start to life and why I n this great leap. I never k

anyone in the entertainn world and never could imagi would be part of it like this." S hard put to explain why she n it to the top of MTV instead of ers but sugg maybe it was al perseverance. "It really undervalued set. It's not sexy, b

you really want something, yo got to hang in there," she sa never phoned it in. I given my share of c lives to this company. And if MTV is to s trendsetter, she'll ha maintain the same

of anything-is-possible spirit has encouraged since MTV's ception. The key, she is creating a space w people feel safe and afraid to fail: "Falling on your face is a great

tivator. So is accident." Her mantra: "The smartest thing we do when confronted by something truly creative is to get o the way." That's pretty much what happened when two y producers came to McGrath in the early 1990s with a new for a dramatic series that didn't require hiring actors or w McGrath was intrigued. The idea was to film seven people li in a New York City loft over several months, following the opera of their daily lives and dropping a soundtrack of new t behind it. MTV's *The Real World* debuted in 1992, and reali was born. Its 17th season is shooting now in Key West.

FRIEND OF BILL

THE SCRAPPY SCRANTON GIRL also trusts her gut. There much debate internally in the early 1990s about whether i wise for MTV to entangle itself in politics. McGrath want hold forums for the Presidential candidates in 1992 and get engaged through the Rock The Vote campaign. She and o felt strongly that politicians needed to hear from kids. To up the momentum after Bill Clinton won, they decided to an official inaugural ball. Certain that Clinton would r show, McGrath says she was taken aback when she got "about halfway through the show that Elvis is in the build she recalls. "Clinton walks in, gets onstage, and says, 'MTV everything to do with my election.' It was the best."

Another flier she took was giving Jon Stewart a se chance in 1998 after MTV canceled an earlier show. When Kilborn left *The Daily Show*, McGrath voted for Stewart a chor. "There's just something about Jon Stewart, right?"

A Never-Ending Makeover

MTV for Life Rather than lose viewers as they mature, MTV Networks has created a new unit to help it capture the 35- to 50-year-old audience with TV channels and broadband sites focused on such lifestyle issues as wealth and fitness.

Mobile and Global Bill Roedy, the head of MTV International, talks about launching and programming new mobile-phone services across the company's global footprint.

The Story Behind the Story For a podcast interview with Senior Writer Tom Lowry by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm



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New York City 311

High performance delivered for government.

More than 2000 non-emergency city services in 170 languages for 8 million residents—services that once took 14 pages of telephone numbers in New York City—are now available 24/7 with a single call to 311. Working closely with the city's Department of Information Technology and Telecommunication, Accenture took the nation's largest 311 project live in just seven months, introducing not just new applications and technologies, but a new way of doing business. Having surpassed the 8 million-call milestone in its first year, the system is giving the city of New York the agility required for high performance.

A photograph of Tiger Woods in the middle of a golf swing. He is wearing a purple polo shirt, dark pants, and a dark cap. He is holding a golf club with both hands. The background is a blurred crowd of spectators.

They're only obstacles
if you can't see
around them.

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says. "The guy has a voice." McGrath is tight with Stewart, who will host the Oscars for the first time on Mar. 5. They talk by phone frequently, mostly chitchat about their kids. And McGrath is one of those rare people who can get Stewart to be serious—well, almost. "We all understand this is a business, but the quality of the content is everything with her," Stewart says of McGrath. Then he quickly shifts to full deadpan. He says he loves the freedom she has given him to extend the Jon Stewart brand. His latest idea: launching a line of casual wear. "It will be one outfit a week. You put it on on Monday mornings and take it off on Sunday nights." When told of Stewart's idea, McGrath guffaws: "Brilliant!"

ECLECTIC TASTES

McGrath's HUNGER FOR FICTION, movies, and music takes in the highbrow and lowbrow. One recent morning, she got up before the rest of the family in their brownstone on Manhattan's Upper West Side to read Kate Moses' *Wintering: A Novel of Sylvia Plath*. Several nights before, she stayed up for Madonna's 1991 concert tour documentary *Truth or Dare*, even as her husband, Mike, begged her to turn the TV off and go to sleep. Whether it's rereading Samuel Beckett's novel *Malone Dies* or scarfing up the latest issue of *us Weekly*, friends say she is voracious. "[Judy] was the only person I ever worked with who knew as much about great literature as what was going on between East Coast and West Coast rappers," says former MTV executive Sara Levinson. "I always thought her intuitive appreciation of storytelling and characters was an enormous secret weapon."

It's the second day of the MTV retreat in Miami, and there's a new urgency in the CEO's message. McGrath praises her team for double-digit ad revenue growth in 2005. But she also warns against complacency in the face of game-changing innovation. In speeches and side conversations in hotel elevators,



Crowning America 2 on MTV's network

McGrath pressed MTV to shed its skin again and reimagine itself. She did that once when she Scranton and created a new life among New York's glitterati. The year her old friend Freston will sell the

Viacom's prospects to Wall Street. So far investors are in a wait-and-see mood: Shares have been flat, at about \$42, since the Viacom began trading on its own on Jan. 3.

McGrath knows that great, envelope-pushing programming is still the answer. That's why she carved out time one afternoon to do what she has done thousands of times, the thing she loves: listen to a pitch. Three top Comedy Central executives in a hotel suite with McGrath to review the slate of possible shows for the year. The channel was sucker-punched last year when one of its biggest stars, Dave Chappelle, vanished mysteriously. So Doug Herzog, who heads Comedy Central, Spike TV, and TV Land and is a close personal friend (he was a witness at a City Hall wedding), is hoping for a big hit to fill the void. (It's not out that the four shows Chappelle taped before he bolted were ready later in the year, so Herzog plans to show them on Comedy Central's new broadband channel, Motherload, and not on iTunes.)

Michelle Ganeless, Comedy Central's general manager, shows McGrath a prospective scheduling grid for the year.

McGrath explains that advertising is looking exceptionally good for late spring. Liane Carroll, Comedy Central's executive president of original programming, shows McGrath a new DVD into a player to show McGrath new stuff. Herzog, Ganeless, and Carroll are all MTV veterans, so the session is a nerve-racking pitch than it is a friends eating chicken sandwiches watching some new material together. First is a clip from *American Lives*, a scripted, part-improvised show about a news team in Spokane, Wash. NBC took it last year; Comedy Central scooped it up. Among the other shows vehicle for politically incorrect comedy is Sarah Silverman and Lewis Black's *State Diaries*. If that flies, it would be a third spin-off from *The Daily Show* and Steven Colbert's *The Colbert Report*.

McGrath watches, laughs, listens to the team, laughs some more, but never takes notes. When it's over, she says "hey, this looks really good," peering again at the scheduling grid for the year ahead, one she knows could be her challenge yet. Then she tosses the grid aside and asks the really important question: Do you think Jon Stewart can get tickets to the Oscars? ■

BIO

Judith Ann McGrath

Cedar Crest yearbook photo, 1974



TITLE Chairman, CEO, MTV Networks

BORN July 2, 1952, Scranton, Pa.

EDUCATION Scranton Central High; Cedar Crest College, BA, English literature

FAMILY Husband, Michael Corbett, formerly a director in systems development at the Federal Reserve Bank; daughter, Anna, 11

CAREER At MTV since its launch in 1981; previously, copy chief at *Glamour* magazine, senior writer at *Mademoiselle*

ROLE MODELS Mother and father, both social workers; Duke Ellington; Gloria Steinem; and Samuel Beckett

LAST BOOK READ *The Year of Magical Thinking* by Joan Didion



BEST DAYS AT MTV Taping of *Nirvana Unplugged*, first MTV Forum with Presidential candidate Bill Clinton, launch of Logo channel

FAVORITE NEW ARTISTS Clap Your Hands Say Yeah, James Blunt, John Legend, Cat Power

NEIL YOUNG SONGS SHE NEVER TIRES OF *Powderfinger*, *Winterlong*, *Only Love Can Break Your Heart*, *Helpless*

OCCUPATIONAL HAZARD Once broke her wrist during a food fight at MTV staff party

PHONE LOG ON A TYPICAL DAY MTV executives Van Toffler and Doug Herzog, Miramax boss Harvey Weinstein, Paramount studio boss Brad Grey, ex-*60 Minutes* Executive Producer Don Hewitt, BET Chairman Debra Lee, Mariah Carey

You've Got the Floor, Kirk

Having won a board seat for Jerome York, Kerkorian has new clout to remake GM

DAVID WELCH

GIVEN THE STATE OF General Motors Corp. these days, you'd think billionaire Kirk Kerkorian must be crazy to invest almost \$1.6 billion in the auto maker. It's hard to fathom how he can make his money back any time soon. But after all speculation that the investor's secret plan was just to carve up the pieces of the company for cash payouts, it turns out he wants to make a profit the old-fashioned way: buying the stock cheap and using management to stage a comeback. "He is not going anywhere," says a source close to Kerkorian's Tracinda Corp. "He likes the GM guys and believes they're listening to him."

That sounds awfully friendly for an investor with a reputation for being such a troublemaker. But at the moment, relations between Tracinda and GM are downright friendly. Kerkorian's top lieutenant, Jerome B. York, has accepted GM's invite to take a seat on the board. Kerkorian has bought back 10 million shares of GM stock to get a tax break in December. And GM Chairman G. Richard Wagoner Jr. has put in motion some of the measures that York suggested in a speech a month ago.

Kerkorian and York are in a stronger position to influence management than most people realize. In a little-noticed move, Kerkorian got his top adviser on GM's board while retaining the right to buy and sell stock as he pleases—a right usually denied GM board members. Just after York



SPECIAL DEAL
Kerkorian can still buy and sell stock

THE STAT

\$1.6 Billion

The amount Kirk Kerkorian has invested in General Motors

accepted the board seat, Tracinda filed with the Securities & Exchange Commission a short note saying that the former Chrysler Corp. and IBM chief financial officer works for Kerkorian only as a consultant and won't share insider information. To avoid conflict of interest—and to pass muster with the SEC—York won't advise Kerkorian on trading GM stock. "It's strange that the person who pays York is free to trade," says Maryann N. Keller, an auto-industry consultant. "That means Kirk can buy and sell as he wants."

Assuming that the SEC has no problem with the arrangement, the upshot is that

York and Kerkorian would be more powerful as a duo with somewhat separate roles than they were before. York has access to the board and can make his case to other directors. Meanwhile, Kerkorian can boost his outside clout by purchasing more stock and even teaming up with other large shareholders. In the spirit of cooperation, GM agreed to the arrangement. Says long-time industry watcher and president of Short Hills (N.J.) consulting firm AutoTrends Inc. Joseph Phillippi: "Kerkorian makes his money when these guys get their [act] together and fix the company."

While GM is scrambling to get any kind of traction in the car market, count on York to comb through GM's financials in a search for operations that need to be dumped. In an interview in early January, York said GM needs to take an approach like Carlos Ghosn's at Nissan Motor Co.: paring away—either through sale or closure—any businesses, brands, or operations that lose money, require too much cash to fix, or distract upper management. Says York: "I strongly believe that a company in need of a restructuring needs to whittle down to its core business."

MISSED DEADLINE

WHAT HAPPENS if Wagoner and York find plenty of other reasons to disagree? At this point, York can only try to get other board members to see things his way. He already watched the Feb. 6 deadline for nominating more board members or filing any other kind of shareholder resolution

come and go. But sources say York has regular conversations with GM board members and has a long-standing relationship with director Kent Kresa, ex-chairman of Northrop Grumman Corp.

That means if GM isn't making progress, York is in a position to get the board to take even tougher action. But don't expect him and Kerkorian to get hostile too soon. York told *BusinessWeek* last month that he wants to help fix an American industrial icon like GM. And although Kerkorian's mission is to make money, he has rarely become hostile and has never pushed a company into bankruptcy (which would, in this case, wipe out the value of his shares). He just wants to see GM make it back from the brink, and make money for him. ■

—With Ronald Grover in Los Angeles



Frontier: Not About To Pack Its Bags

It's countering Southwest's arrival in Denver with competitive fares and new planes

BY MICHAEL ARNDT

SINCE JEFF S. POTTER BECAME chief operating officer of Frontier Airlines Inc. in 2001, he has had his share of trials and tribulations, from the post-September 11 plunge in traffic to sky-high fuel bills. Still, the discount carrier has managed to grow 20% a year and was one of only a handful of airlines that could boast two profitable quarters in 2005. Now Frontier's CEO, Potter is up against a force that investors worry may be far harder to manage: Southwest Airlines Co. The largest, richest, most feared carrier in the domestic industry has just launched service in Frontier's hometown hub, Denver.

Southwest has handily crushed its competitors as it has spread across America. Simply by announcing its Jan. 3 entrance to the nation's No. 5 airport, the

juggernaut whacked 28% off of Frontier's share price in a day. But Frontier may just be the little airline that could. Thanks to its own low cost structure, deft redeployment of planes, superior in-cabin services, and a loyal following, Potter says Frontier's overall growth should be unaffected. "I'm very positive on the Frontier story," he says. January bookings suggest that his optimism is justified.

Other upstarts are showing they can beat Southwest at its own game, too. While major carriers such as United Airlines and Delta Air Lines Inc. are ceding ever more of the U.S. market to Southwest, JetBlue Airways Corp. and AirTran Airways have expanded coast to coast, serving many of the same destinations and bargain-hunting passengers as Southwest. Yes, fuel costs hurt: JetBlue says it will lose money through 2006 unless prices ease. But the up-and-comers will become more compet-

itive as Southwest, which locked in costs years ago, must buy fuel at too prices as its hedges expire.

Although Frontier executives expected Southwest to show up in their market 2006, they didn't expect it to happen quickly. Nor did Southwest. But with Orleans shut down by Hurricane Katrina it had spare planes. So in late October, Gary C. Kelly announced that the Dallas-based airline would begin flying to Denver barely 10 weeks later. One-way fares as low as \$59, Southwest opened with 13 departures a day to Las Vegas, Phoenix, and Chicago. But that's just a start. Upon taking a third gate at Denver International Airport in March, Southwest will add two more cities, and Kelly says its schedule could triple by yearend when it gets two more gates. "It's a ripe opportunity," he adds.

Southwest will be in for a hard fight. Potter, 45, has worked off at Frontier since it was founded in 1994, and he knows how to compete the industry's big guys. United Airlines and its budget affiliate Ted natever, with 55% of its traffic. But by consistently underpricing United and adding many as five markets a year, Frontier steadily gained market share and ranks second with 21% and flights to destinations in the U.S. and Mexico. Revenue should top \$960 million in its

Frontier has a fought the battle carrier before

Arsenal

Frontier Airlines, Denver's hometown carrier, has a fierce new competitor in Southwest. Here's how it readied itself for the fight:

CUT COSTS

Frontier can match Southwest's fares by keeping costs down, thanks to a mostly nonunion workforce that hustles planes through gates. Cost per air service mile for Frontier is \$6.02, vs. Southwest's \$6.31.

FILL THE SKIES

Expansion plans have been slowed so that Frontier can reassign new aircraft in order to boast of more flights than Southwest: It runs 19 flights from Denver, 6 more than Southwest.

PLEASE THE PASSENGER

Frontier carries 24 channels of real-time TV on seat-back displays, plus has assigned seats with more legroom. It also offers a bigger snack than Southwest's bag of pretzels.

STEADY
Frontier's
modest cost
structure
will help

iscal year, which ends Mar. 31, and
sts forecast Frontier will post a
cost decline, while the major airlines
re rejected to rack up mega-losses.

UNION EDGE

OTHER AIRLINES that Southwest
argeted, Frontier slashed fares by
0% or more to match Southwest's in-
actory bargains. In Philadelphia,
rier market that Southwest entered
onths ago, incumbent No. 1 carrier
Airways Group Inc. couldn't weath-
rice war and beat a hasty retreat.
unlike the so-called legacy carriers,
rier can make money even at these
ate prices if fuel prices abate, says
H. Tate, the company's chief finan-
a officer. Indeed, with a younger,
oly nonunion workforce that quickly
et planes back in the air, Frontier's
oniel costs are lower than South-
es. And with fuel costs likely to stay
ygh, Tate is evaluating 55 proposals
oc costs further, from slowing takeoff
pels to sending airport employees
one early if they run out of things to
o, get back in the black.

itter has also slowed Frontier's
ui out to two or three new markets in
06. That way he can add planes to
ous Southwest is flying and maintain
nge in scheduling. Even if Southwest
ips flight offerings in Denver, Frontier
arutflank it, argues Potter: It's adding
ev new planes this year and five more
207. Indeed, Frontier carried 15,000
passengers on routes that South-
flies in January, up 38% from a year
go-though cheaper fares mean the up-
ur may not hit the bottom line.

ontier has another trump card: serv-
ce. offers fliers 24 channels of pay-per-
ie TV on seat-back screens and roomi-
r eats. "Southwest's going to have a
ar time penetrating the Denver mar-
et," says Goldman, Sachs & Co. analyst
len D. Engel. "This won't be as bad for
rier as the market expects." ■

Should Doctors Own Hospitals?

Controversy builds over a fast-growing, profit-driven business

BY ARLENE WEINTRAUB

BURIED IN THE DEFICIT-reduction bill that President George W. Bush signed on Feb. 8 was a mandate that could put the kibosh on a hot trend in health care: hospitals

that are partly owned and run by doctors.

For years critics have complained that when doctors invest in hospitals, conflicts of interest arise that could endanger patients and threaten the survival of general hospitals. The critique cuts across the political spectrum, voiced by the likes of Senator Charles E. Grassley (R-Iowa) and Representative Pete Stark (D-Calif.). In 2003, Congress placed a moratorium on enrolling such facilities in Medicare and Medicaid while it examined the criticisms. The

suspension was supposed to end on Feb. 15, but the signed budget bill requires that the Centers for Medicare & Medicaid Services extend the moratorium as much as six more months, while it prepares a report for Congress.

The Medicare delay has chilled what was once a fast-growing niche. Business took off in the 1990s when gargantuan hospital chains such as Tenet Healthcare Corp. went on consolidation binges. Bands of doctors broke away and built facilities that would let them practice medicine unfettered by administrative rigmarole. They boosted efficiency and profits by specializing in lucrative practices such as orthopedics and cardiac care.

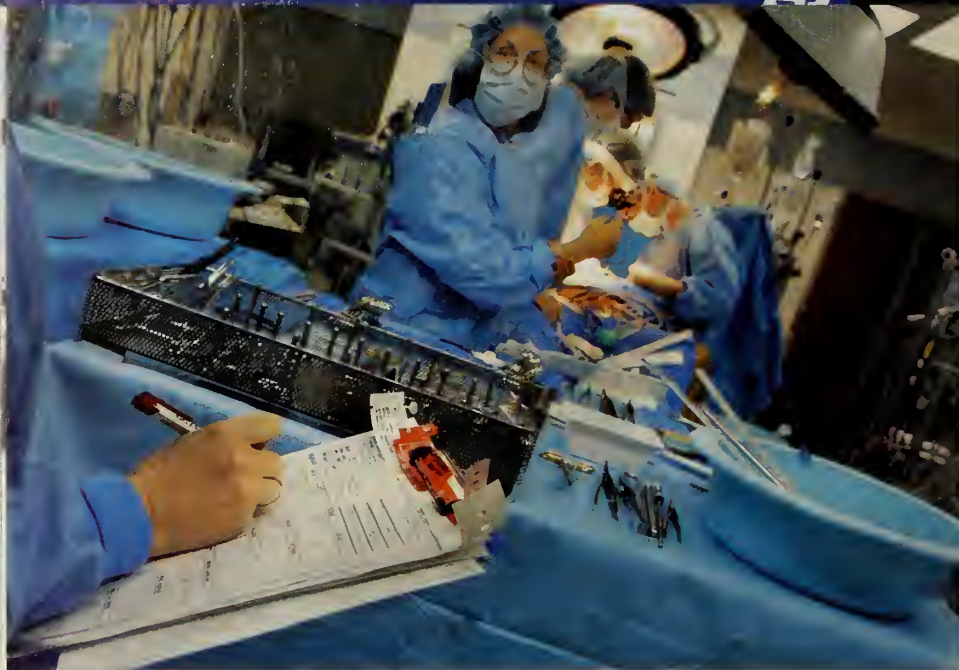
Now there are

OWNER OPERATORS

Proponents say specialization leads to better care



SCOTT GOLDSMITH



more than 100 physician-owned specialty hospitals. Proponents like Dr. Richard I. Fogel, vice-chairman and part owner of Heart Center of Indiana in Indianapolis, say such facilities offer patients superior care. But the business may soon be in jeopardy. "If Medicare were to decide patients shouldn't come here, we'd have to reevaluate the business model," Fogel says.

One concern about specialty hospitals is that they selectively treat the most lucrative patients. A study of heart hospitals in Arizona found that about 21% of patients admitted to physician-owned hospitals undergo routine surgeries such as a heart bypass but are otherwise relatively healthy. Only 10% of patients fit that profile at facilities that aren't doctor-owned; the vast majority are more complicated and expensive to treat because they have serious problems, such as diabetes and other chronic conditions.

"THIS ISN'T FAIR COMPETITION"

WHEN PHYSICIAN-OWNERS focus on less complex cases, they still earn returns on ancillary services, such as X-rays. But they dodge having to dole out care that isn't adequately reimbursed, such as nursing costs for patients who linger for days after their surgeries, too sick to go home. "When you're an owner, you have an incentive to make sure every case is profitable," says Jean M. Mitchell, professor of public policy at Georgetown University and author of the Arizona study. "It's scary."

Some critics charge that specialty hospitals also slough off uninsured patients, who invariably end up in the emergency

rooms of nonprofit hospitals. Those hospitals, facing an exodus of insured patients to specialized rivals, may find it hard to stay afloat since they can't balance the cost of treating the uninsured with profits from performing pricey procedures on the insured. A study by the Texas Hospital Assn. (THA) found that the year after a heart-imaging facility opened in one town, the cardiac care center at the nearby community hospital slid from a \$524,646 net profit to a \$20,786 net loss. "We're all for competition," says THA spokesman Gregg Knaupe. "Problem is, this isn't fair competition."

Specialty hospitals may also drive up aggregate health-care costs by spurring demand for pricey elective surgeries, according to a Jan. 25 survey by the Center for Studying Health System Change in Washington. The THA, the American Hospital Assn., and several other groups are lobbying legislators to impose some restraints, such as barring physicians from referring patients to hospitals they partly own.

This infuriates physicians such as Dr. John R. Harvey, co-president and cardiologist at Oklahoma Heart Hospital in

HEART CENTER OF INDIANA It's one of more than 100 physician-owned facilities in the U.S.

Oklahoma City, says critics overlook the positives for patients of physician-owned hospitals such as their tendency to have n

nurses on the floor and to invest more high-tech gear. In fact, specialty hospitals often score high marks from independent rating agencies such as Health Grades Inc. Harvey adds that at hospitals such as his, a physician rarely owns more than a 3% stake. "To suggest I would admit a patient because I'm motivated by a minuscule profit margin is a scene," he says.

Other physician owners highlight the value of specialization. "We're focused on doing one thing and doing it extremely well," says Dr. John W. Dietz, chairman of the board of manager Indiana Orthopaedic Hospital in Indianapolis. "We think focused care is a great model for medicine."

In addition to stalling the experiment of doctor-owned facilities, the Medicare moratorium has been painful for many investors. MedCath Corp. in Charleston, N.C., which partners with physician-

operating 12 heart hospitals, has been forced to hold off on its expansion plans. The company's stock has fallen nearly 35% in the past 18 months, to 18.80.

With the suspension likely to be extended, the onus is now on the Centers for Medicare & Medicaid Services to work with the conflict. The agency, says a CMS spokesman, will prepare a rule that addresses conflicts of interest concerns, including scrutinizing how physician-ownership is structured and examining how such hospitals treat uninsured patients. Based on these findings, Congress will decide to revamp rules for physician-owned care. Legislators are facing a tricky

Where It Hurts

Critics say conflicts of interest arise when physicians invest in hospitals that specialize in lucrative fields such as orthopedics or cardiac care. They charge that:

- Financial incentives influence treatment decisions
- Only the easiest, most profitable cases are treated
- Specialty hospitals avoid the uninsured, who end up in community hospitals' emergency rooms
- The profits of nearby community hospitals suffer

says Stuart Gutterman, senior program director at the Commonwealth Fund Program on Medicare's Future in Washington: "They'll have to balance physicians' desires with the concerns of patients and communities." ■

EDITED BY ARLENE
ENTRAUB

INNOVATIONS

Malaria forecasts,
managing the loo

Malaria-carrying
quitos thrive in hot,
id weather, and the risk
epidemic increases
a particularly rainy
on. A team led by the
ersity of Liverpool has
loped a computer model
uses long-term weather
casts to predict
emics up to five months
vance. That's earlier
any other forecasting
nod, and may provide
igh warning to kick off



vention programs. The
which is being tested in
Botswana, combines seven
different global climate
models, and incorporates
with statistics and data on
disease vulnerability from
Botswana's health ministry.
Scientists at the
University of New South
Wales in Australia hope to
eat one of the world's most
hard chores: cleaning the
bathroom. They're developing
coatings made from particles
of titanium dioxide, which
absorb ultraviolet light. The
light prompts the particles to
kill microbes—potentially
even more powerfully than
bleach does. If it works,
bathroom surfaces would
essentially clean themselves
when exposed to UV. One
potential hitch is that right
now the coatings can only be
activated with sunlight, so the
technology is rejiggering the
particles to work indoors.



WINEMAKING

STUDYING MOLECULES TO BUILD A BETTER GRAPE

CONNOISSEURS pride them-
selves on their ability to judge
the quality of wine by sniffing
it and swishing it around in
their mouths. The distinctive
bouquet comes from
compounds called volatiles.
Scientists at the University of
British Columbia in
Vancouver are studying the
molecules in an effort to
make fine wine even finer.

Plant volatiles emit
invisible chemical clouds that
people perceive as smells and
tastes. Today, winemakers

base their harvest and
fermentation practices on
relatively unscientific
predictions of when volatiles
will be produced in the skin,
flesh, and seeds of wine
grapes. The Canadian
researchers hope to refine
that practice by using what
they learn about volatiles to
manipulate the grapes' genes,
and maybe to overhaul
pruning and fertilization
methods. A paper they wrote
on grape chemistry is
featured in *Science*.

CANCER DRUGS

WHEN IMMUNE CELLS JOIN THE OTHER SIDE

THE IMMUNE system doesn't
always protect us. It runs
amok in diseases such as
lupus, and it may also help
tumors resist some anti-
cancer drugs.

In the Feb. 10 issue of *Cell*,
researchers at the University
of California at San Diego
School of Medicine report
that macrophages, which
normally keep connective
tissue healthy, can interact
with prostate cancer cells to

cause inflammation. That
may help explain why one
important class of drugs loses
effectiveness over time.

The drugs work by
blocking genes that are
activated by male hormones
called androgens, which play
a role in both normal and
abnormal prostate growth.
The UCSD team believes that
when macrophages interact
with tumor cells, they prompt
changes that allow tumors to
resume expressing these
growth-related genes, even in
the presence of the drugs.
Further studies may show
whether it is the inflammation
that changes the activity of
the drugs.

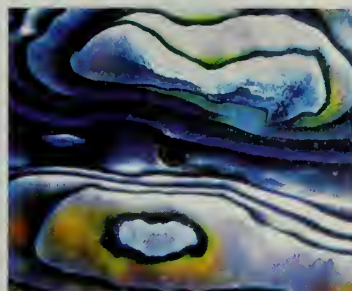
—Neil Gross

MEDICINE

A SEA CHANGE FOR ARTIFICIAL BONES?

SCIENTISTS at the U.S.
Energy Dept.'s Lawrence
Berkeley National
Laboratory are developing a
type of artificial bone that's
inspired by oysters, abalone,
and other hard-shelled ocean
dwellers. And they're using a
property of seawater to
speed the process.

When seawater freezes, it
forms stacked layers of
crystals. The researchers
found they could exploit the
same freezing process to
mold ceramic materials into
layered structures that
mimic the properties of a
substance in the shells called
nacre, which makes them
light and strong. The new
material is four times
stronger than synthetic bone



used today, and less likely to
trigger inflammation of
surrounding tissue.

The researchers hope to
come up with a light, durable
scaffolding that will
incorporate both natural
bone cells and an organic
material that will release
growth-stimulating
compounds as it degrades.
New bone cells will then
gradually fill the pores of the
scaffold, fusing the natural
and artificial bone together.
The material might also be
used in body armor and
airplane and computer parts.

—Helena Oh

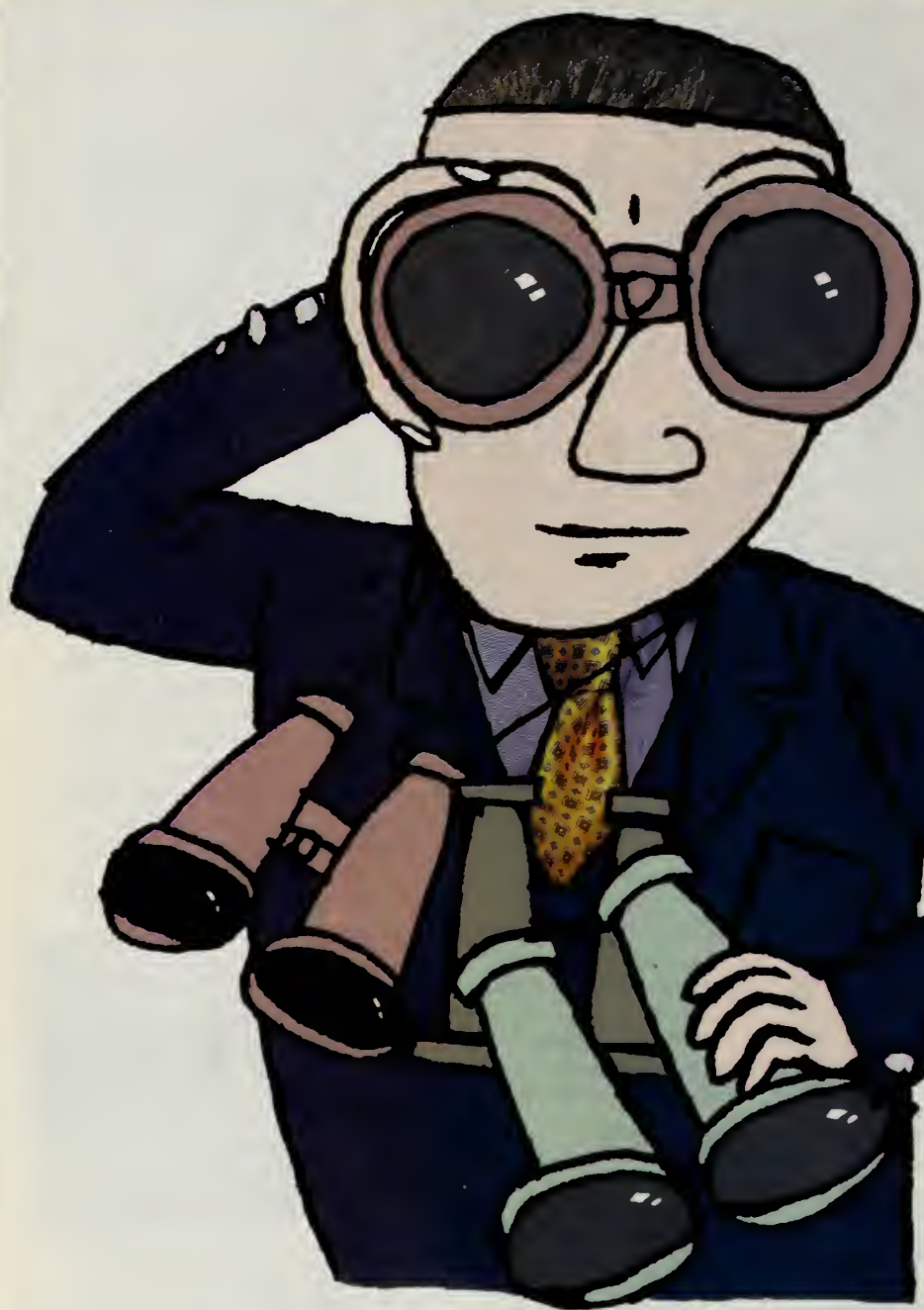
BY BEN ELGIN

RON CONWAY HIT PAY as one of Google's early bankrollers. But don't try to convince him the search giant has a hammerlock on the sector. Sure, Google has some estimates, but nearly two-thirds of the world's Internet queries. It also shells out half a billion bucks each year on research and development and plucks the top engineers from powerhouse universities. Nevertheless, Conway believes that some of the most interesting search innovations will emanate from companies not named Google or, for that matter, Yahoo! or Microsoft. Over the past two years, he has bet heavily on this hunch, putting money in nearly two dozen startups. "Search is in its infancy today," says the seasoned Silicon Valley investor. "I think 10% of its potential, maybe."

Conway is by no means alone. A flock of startups has descended on the lucrative search industry. Last year, \$263 million in venture capital poured into search outfits, says research firm Dow Jones VentureOne. The figures have risen steadily since 2002, when \$580 million went into nine startups. "It's shocking to go from drought to flood as quickly as we have," says Bradley Horowitz, Yahoo Inc.'s director of technology development.

The boom in startups suggests a technology renaissance ahead, and could mean big changes for Internet users. While Google and other giants seem wedded to the current paradigm of type words into a rectangular box, and a list of 10 blue links—startups are throwing caution to the wind. Without existing users to alienate, they can afford to think everything from the search interface to the formulas used to deliver results.

The result is likely to be a move away from a single ubiquitous search engine to find info on the Net. Instead, people will use several different search engines, tailored to a specific task. One might specialize in blog postings, another in news clips, and a third in general information. The shift may look like the evolution of TV, from a world dominated by the Three networks to one in which hundreds of cable channels specialize in topics from cooking to history. "People are looking for targeted, specific information that search engines can't provide," says Michael



A Search Engine For Every Subject

Google and Yahoo rule, but a flock of upstarts is offering new ways to find info

CEO of Become.com, a search engine focused on Internet shopping.

By fledgling firms are tackling the leaders head on. Companies such as Google and Yahoo have spent years of millions of dollars designing powerful engines that include mathematical algorithms that scour, sift, and rank billions of Internet pages at the click of a mouse. It's an engineering feat that even Microsoft Corp. can't easily replicate. But the upstarts are finding a wealth of opportunities even in the cracks of the search players.

Many of their innovations could well end up in the pockets of Google or Yahoo, which haven't been away from acquiring promising startups. In the past two months alone, Microsoft's MSN, Yahoo, and America Online have all snapped up search-related startups to bolster their technology offerings. Although prices haven't been disclosed, they have been selling in the range of \$10 million to

\$50 million, say investors. Conway thinks that 75% of the companies in search will be acquired or go out of business. "The dangers of falling into that latter category are omnipresent, particularly as a lot of startups builds. On one hand, promising outfits want to be known by potential acquirers. Yet a Google or Yahoo could simply shift around an R&D budget or two and wipe out the prospects of several entrepreneurs.

TALNT SHORTFALL

IT'S NOT THE ONLY challenge the tech giants impose on startups. Google's voracious appetite for engineers has cleared the upper echelons of many a graduating class of computer science majors, according to professors from the University of Washington to Stanford University. When Google can't make the hire, Yahoo and Microsoft often pick up the slack. The ongoing talent shortfall has crimped many grand plans. For instance, Conway hoped to launch a business incubator, between Innovations, for startups. He had planned to build three teams, each with five engineers, to hatch fledgling companies. But after struggling to hire the chiefs, he scrapped the operation to focus on his roster of investments.

Despite perils, opportunity abounds. For instance, many startups are con-

vinced the industry's methods for selecting the most relevant sites are set for an upgrade. Google provided a big jolt seven years ago, by analyzing the links that connect sites. Among other factors, Google decided that the more sites that link to your site, the more important your site.

Today a number of startups are attempting to infuse human preferences into computer algorithms to pinpoint relevant information better. For instance, somebody searching for a nearby bicycle

If people come to Google and type in "Xbox," they could be looking for the site *Xbox Addict*, a list of games, or possibly trying to buy a new video-game console. But a person who plugs in a similar query at a shopping search engine has already made a statement about intent.

The search behemoths are developing their own niche engines, but their tech prowess may not carry over. Often, relevant information such as a job posting or a real estate listing exists only fleetingly

The Hunt for Tomorrow

Prompted by Google's success, entrepreneurs have been swarming into the search business. U.S. startups snagged \$263 million in 2005, up 38% from a year earlier.

SOCIAL SEARCH Google depends on math formulas to figure out its search results. What if you used people instead? Dozens of startups, including Jeteye and Kaboodle, are using the experiences of prior searchers to offer more useful results.

GO LOCAL While a half-million small businesses promote themselves with search ads, millions more keep using the Yellow Pages. One reason: It's tough to target one town or region with Net ads. Startups such as MerchantCircle are trying to solve this problem.

NICHES RULE Finding a digital camera is entirely different from, say, researching the history of the death penalty. Narrow industry searches benefit from technology tailored to the specific task. This possibility has inspired newcomers such as Trulia.com in real estate and Become.com in shopping.

store may benefit from knowing which shop's site has been most frequently bookmarked by people in the neighborhood, or described in the most favorable terms. "It gets interesting when human knowledge begins to intermingle with algorithmic search," says David Hayden, CEO of startup Jeteye Technologies Inc.

This "social search" is the source of a recent acquisition binge at Yahoo. In the past year the company has snapped up at least five startups focused on building online community content. "Our belief is: better search through people," says Yahoo's Horowitz.

It's not the only way search startups hope to improve discovery of sites. Many believe the answer will come in the form of niche sites. While Google and Yahoo have proved adept at filtering through billions of documents to come up with a list of pertinent results, this approach hasn't thrived in narrow industries, such as shopping, real estate, or health.

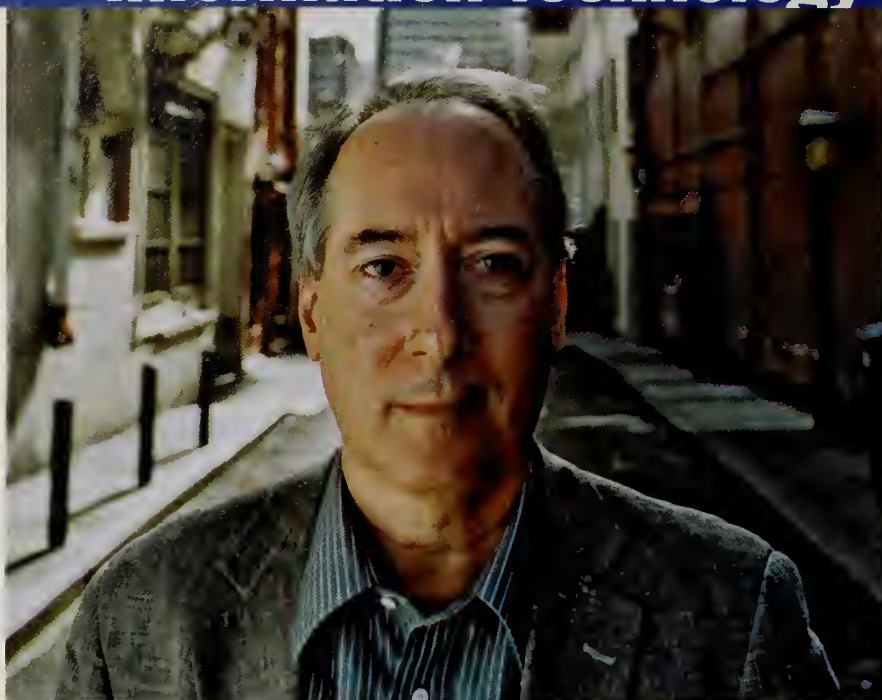
Why? The engines can't really know users' intent when they plug in one or two words and hit "enter."

and is barely noticed elsewhere on the Web. Because other sites typically won't link to, say, a short-lived job opening, it means the technical advantages of major engines won't be a crucial factor. In addition, startups may get a more receptive greeting in industries such as classified ads, where data are like gold and Google is viewed as a threat. "The information that is important might be pictures, inventory information, freshness of data, or accurate product info," says Theresia Gouw Ranzetta, managing partner at venture firm Accel Partners and a backer of real estate site Trulia.com. "It doesn't lend itself to link analysis."

All these opportunities don't portend Google's demise by any means. Indeed, look for Google and its competitors to snap up many promising startups. But with less to lose and a clean technical slate, these newcomers will probably force sizable change in the industry—and in the ways we all search for information on the Net. ■

CONWAY Search is still "in its infancy"





Great Online Expectations

Bayosphere wanted to reinvent journalism. Here's how the dream died

BY HEATHER GREEN

DAN GILLMOR'S EFFORT to reinvent journalism through Net startup Bayosphere ended, appropriately enough, on the Internet. On Jan. 24, Gillmor, a reporter turned entrepreneur, posted an open letter online conceding that his attempt to build a community news site for the Bay Area wasn't gaining traction. He said he was shifting his focus to academia. "The site didn't take off—in large part, no question about it, because of my own miscues and shortcomings," he wrote.

Gillmor's downfall echoes loudly throughout the troubled newspaper industry. While many ink-smudged journalists viewed his effort with suspicion, Gillmor's dream was to create a sustainable model for producing local news. As

services such as Craigslist have drained away classified ad revenue, papers have increasingly been deprived of the resources to cover local news. With Bayosphere, Gillmor was betting the same Net phenomenon gobbling up ads could be used to establish a new type of media outfit. In his vision, legions of citizen reporters would work with professionals on news stories and blogs to produce coverage no musty newsprint could match.

Gillmor inspired dozens of similar news sites that are gaining ground in their communities. They're sure to learn from his mistakes. The former columnist at the *San Jose Mercury News* threw himself into the fray in December, 2004, announcing on the paper's blog that he was leaving after 10 years. He raised venture funding, and in February, hired Michael Goff, founder of *Out* magazine.

The pair suffered missteps almost from

GILLMOR His efforts have inspired other entrepreneurs

the start. For thing, they s much of time search for distribution partners, cutting into effort to build a community of readers reporters. But traditional media were experimenting with their own citizen journalism to a greater degree than Gillmor expected, and they didn't want to team up. He never signed a partner.

Meanwhile, Gillmor struggled to establish an active community of readers and reporters. In July a promising meeting was held over lunch in Bayosphere's San Francisco offices. But there was no single follow-up. Gillmor also didn't set up an organized way for members to be involved in the site, say by editing or policing comments. "What's needed for any participatory project is a sense of ownership," says Mini Kahlon, a Bayosphere participant. "That was missing."

Gillmor generated frustration in other ways. He put his own blog front and center on the Web site—to attract readers, he says. But that relegated others to less prominent pages. He also depended on technology tools to collaborate with members, to the bafflement of would-be contributors. "I tried to use the new room tool but I was stumped," says G. Weiler, another Bayosphere member.

DISCIPLES MARCH ON

LAST FALL, ONLY eight months after launching the venture, Gillmor began to question its prospects. By the time he wrote his letter, he had lined up a job creating a Center for Citizen Media at Harvard University and the University of California at Berkeley. "What's really important to me is to help figure out the future of citizen journalism," he says. "I think I can get more done with this new thing."

While the guru plans a career change, other media outlets are picking up on lessons of his effort. Nashville's WTVB-TV is engaging locals by including local bloggers in its Net initiative. Fence.com is trying to drum up interest in the sites it's building for three Virginia towns by reaching out to people in and Little Leagues. Many entrepreneurs say Gillmor, whatever his own success, has helped motivate them. "He's the son we're all here," says Susan Decker, co-founder of BackFence.com. "He had an incredible vision about what should be." ■

BusinessWeek online For a look at community sites gaining traction, go to www.businessweek.com/extras

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want
you to
know

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A new study* shows that integrating Medical, Pharmacy and Disease Management benefits with Aetna can help lower medical costs. According to the data, overall costs dropped by 15-20% for high-risk Aetna members with integrated benefits compared to similar members with just medical insurance benefits. That's because integration allows for a better exchange of information to help high-cost, high-risk members better manage their conditions. To find out more, call your broker, Aetna representative, or visit us today at aetna.com.

We want you to knowSM



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Class, Take Out Your Games

How teachers are using computer games to pique the interest of tech-savvy kids

BY CLIFF EDWARDS

JOSEPH DURANT, A 10TH-grader in Washington, D.C., has new respect for what it takes to be the President. Schoolmate Ciara Belle calls herself Cleopatra and feels comfortable talking about ancient Egyptian civilization. Miles away, in Charleston, W. Va., Catherine Carte suddenly believes gym class may be the best period of her school day.

The one thing they have in common? Computer games are behind their new attitudes. They're all studying at schools that let students use games in the classroom to become virtual Cleopatras, Bushes, or Baryshnikovs. And for these students, learning has never been so engaging. Gym was "horrible, absolutely horrible," says Carte, who now supplements traditional physical exercise by working up a sweat moving to a game called *Dance Dance Revolution*. "I was like, 'O.K., I'll see what it's about before I start hating it.' But I really liked it."

These days, computer games are usually pilloried for excessive violence and sex. Yet teachers across the country are bringing certain games into their schools as a way to pique students' interest in everything from history and politics to physical fitness and music theory. Among the most popular are Firaxis Games Inc.'s *Civilization* games, Take2's *Railroad Tycoon*, and Carte's new favorite, *Dance Dance Revolution* from Konami Corp. "We have to embrace the technology, because that's the future," says Tim Meegan, a Chicago history teacher who uses *Civilization*. "You have to either get on board or get out of the way."

Game developers estimate that at least 10% of the classrooms in the nation's 2,500 major school districts use main-



Play and Learn

Games aren't just for after school anymore. A few examples of classroom hits:

DANCE DANCE REVOLUTION

Instead of traditional gym class, kids dance and gyrate in time to pulsing musical scores.

CIVILIZATION

Players build empires in Europe, North America, Asia, or a dozen fictional settings.

RAILROAD TYCOON

Players learn by building new railroad routes, buying and selling stocks, and initiating hostile takeovers.

stream titles for learning, up from only a handful five years ago. The adoption rate appears to be accelerating. In February, West Virginia began rolling out *Dance Dance Revolution* as a fitness tool to all 163 middle schools, part of a \$600,000 program to equip all state public schools by 2009. In Hawaii, teacher Leighton Nakamoto received scores of calls after he presented a paper at a state education conference on how the game can be used

to teach music history. And in the national capital, several schools will incorporate *Civilization* games into their lessons for the spring semester.

Teachers abroad are grabbing game controls, too. A January survey of British teachers found one-third use games in class to help develop motor skills or teach topic-specific subjects, and 59% would consider doing so. Australian game developers held a workshop on the subject in November.

In part, the movement comes because many young teachers grew up playing games and recognize the value of incorporating interactive features into learning. Jeremiah McCall, a teacher at Cincinnati Country Day School, uses *Civilization III* to illustrate European imperialism.

DIGITAL FITNESS
Making physical education fun in class

pean imperialism says mainstream games now encourage more problem solving and constructive thinking than ever before.

"I want them to be able to evaluate evidence, put it together to form their own interpretations of the past, critique other people's interpretations," he says.

Others argue that computer games in physical education classes can make them more inclusive. In West Virginia, a study showed that nearly half of the 5,887 children screened from 1999 to 2002 were overweight. When the state launched a pilot project to determine whether *Dance Dance Revolution* had health benefits, Catherine Carte's mother rolled her. The 13-year-old dances to music on a 16-foot-square metal mat in the recreation of arrows on a screen. She says gym is a pure joy and has lost 20 pounds.

For game developers, the move into the classroom opens new opportunities to

attract more gamers. Since complex games typically cost \$20 million to develop, few companies will rely solely on the education market for profits, says Leah Briggs, community relations manager at Firaxis. "Our plan is to keep creating what we do—create games that are fun for everyone to play and maybe learn from," she says. Educators are looking for just such software to change the rule of the game in their classrooms. ■

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Attack of the Hungry Hedge Funds

To hike stock prices, they're banding together to force changes on companies

BY MARA DER HOVANESIAN

ACTIVIST HEDGE FUNDS had a banner day on Feb. 7. Before the stock market opened, General Motors Corp. finally succumbed to months of pressure from billionaire Kirk Kerkorian and his Tracinda Corp. investment fund by slashing its dividend, cutting executive pay, and naming a Kerkorian adviser to the board (page 61). In the afternoon, an adviser to billionaire hedge fund manager Carl Icahn issued a 343-page paper detailing how to break up Time Warner Inc. and release about \$40 billion in shareholder value.

Boosting share prices rather than taking over underperforming companies is the name of the game, and any strategy to achieve that seems fair play. The new activists often band together and swarm all over the management. They seek new allies such as Wall Street's investment banks. Icahn, for example, signed up Lazard LLC to bolster his fight against Time Warner. And they garner support from shareholders by using savvy media campaigns and the Internet. Take William A. Ackman, founder of New York hedge fund adviser Pershing Square Capital Management LP, who was trying to force McDonald's Corp. to restructure. On Jan. 18 he broadcast a standing-room-only PowerPoint presentation of his proposals at the Millennium Broadway Hotel in Times Square via Internet video and offered a free call-in

number. Some 800 shareholders, analysts, and reporters attended or tuned in. "These were exactly the kind of people whose attention you wanted to get," says Ackman, who holds just a 4.5% stake.

Once they've got their teeth into a company, the new activists usually won't let go. "I stand up for all I'm entitled to and will accept nothing less," says Phillip Goldstein, founder of Bulldog Investors LLC, which fought a long battle to force Blair Corp., a Warren (Pa.)-based catalog retailer, to sell its \$174 million portfolio of receivables. Such tenacity makes them formidable infighters. "Companies that still have a pre-Enron mentality are going to get swamped by this new activism," warns Ralph V. Whitworth of Relational Investors LLC, which has been instrumental in forcing restructurings at Waste Management and Mattel.

The new activists are more dangerous to management than their predecessors. For starters, unlike mutual and pension fund managers, which often are trying to sell money management services to companies, the hedge funds are not tempted to pull their punches. In addition, they're so well bankrolled that they don't have to borrow money from others as the 1980s

raiders did, and they can afford long-drawn-out fights with management. "With more than \$1 trillion in assets controlled by hedge funds, they have credibility and capital," says Stefan Selig, global head of mergers and acquisitions at Banc of America Securities. "Companies have to take this threat seriously;

the balance of power is shifting away from boards. You can't ignore them just because it's some hedge fund you never heard of."

The new tactics can produce faster results than traditional methods of pressuring managements through shareholder resolutions on the agenda at company annual meetings. For example, about a week after Ackman's audio-visual pummeling of McDonald's, the company unveiled a plan to sell 1,500 company-owned restaurants, buy back \$1 billion of stock in the first quarter, and provide more financial disclosure—all similar to the moves Ackman had called for. Last April, Blair announced it would sell its receivables portfolio—as Bulldog wished—at a 6% premium. Even before the transaction was done, Blair took out a loan to buy back the stakes of Bulldog and other investors at 42 a share.

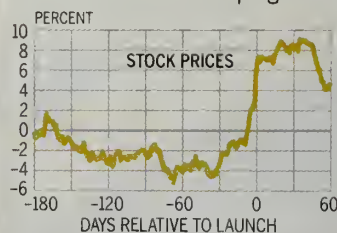
NO HOLDS BARRED

THAT'S NOT TO say that the activists have abandoned proxy fights at annual meetings. Far from it. Hedge funds made use of last year's proxy season to do everything from pushing for a sale of the company (Siebel Systems) to demanding higher merger prices (MCI, Provident) to sinking deals (Mylan Labs, Johnson Controls.) They have come out swinging in 2006 as well. Hedge funds Pardus Capital Management LP and Liberation Investment Group sought additional seats on the board of Bally Total Fitness Holding Corp. Ligand Pharmaceuticals Inc. settled a similar fight with Third Point LLC prior to its annual meeting.

In fact, the new strategies mean that such corporate battles are now year-round affairs. At any moment, an activist fund can take a position in a target company and quickly start pushing for change. The first move is a salty open letter to management. When Icahn, who manages various activist funds, wrote to Warner shareholders on Oct. 11, he wrote, "Unless this legacy of poor decision making is fully recognized and the record of mistakes and inaction will continue to the detriment of shareholders," he wrote. It was the official opening

CREATIVE VALUE

Returns on stocks soar once activists launch campaigns





war for the future of the company. Activists are also recruiting new allies on Wall Street. In June, 2005, Pershing's Ackman hired Blackstone Group LP, a leveraged buyout and acquisitions advisory firm, and money manager, to write a professional "fairness opinion" on the merits of its restructuring plan for fast-food chain Wendy's International Inc. It was the first time activists had used such a tool. Wendy's adopted Ackman's proposal on July 9, just a few weeks after it received Blackstone's missive. The stock has since gained 28% to its current 58. "Wendy's

did everything we asked," said Ackman. "I think this tactic will be used again."

In fact, it may have inspired Icahn to hire banker Bruce Wasserstein of Lazard to strengthen his arguments by coming up with recommendations for restructuring Time Warner. Richard Parsons, Time Warner's CEO, certainly took the threat seriously enough to hire Goldman Sachs Group and Bear Stearns to help ward off the attack.

The activists sometimes have a far longer fight on their hands than they expect, especially if they take the battle to

court. Consider the clash with Philadelphia-based Sovereign Bank. On Oct. 24, Sovereign bought Independence Community Bank of Brooklyn, N.Y., and financed it by selling a 19.9%, \$2.4 billion minority stake of itself to Spain's Santander Bancorp. Relational Investors was Sovereign's largest shareholder and already had been fighting with the bank over governance issues, and demanding two board seats.

LEGAL WEAPON

AFTER THE SANTANDER deal, Relational's Whitworth asked the New York Stock Exchange to mandate a shareholder vote on the transaction. He also ran full-page ads in *The Wall Street Journal*, *The New York Times*, and *The Washington Post* to drum up public support. The NYSE ruled that since Santander was taking less than a 20% stake, no shareholder vote was needed. He took his case to the Securities & Exchange Commission, which, like the Office of Thrift Supervision and the Federal Reserve, has yet to rule on the deal. Each side has filed a couple of lawsuits on various issues. Sovereign's camp may have landed the ultimate legal weapon—legislation. On Feb. 1 Pennsylvania lawmakers passed an anti-takeover bill to fight off dissidents. Institutional shareholders have lined up with Whitworth to urge Governor Edward G. Rendell to veto the measure, which he has to approve by Feb. 12.

Companies are often loath to admit that the activists do come up with eminently sensible ideas. Providing that management can save face, there's scope for the warring parties to find a mutually beneficial resolution. In the case of Blair, Bulldog and its supporters had

Their deep pockets give these activists credibility

to sign an agreement not to buy shares for five years. That suited Bulldog fine: Blair's stock had risen 70% since Bulldog started buying stock. At the same time, Blair's CEO, John E. Zawacki, got to keep his company. Even if the result was good for Blair, its managers are in no mood to say so. Says a person close to the deal: "They don't want to bring any attention to themselves again." With so many hedge fund activists swarming around, many managements can probably relate to that. ■

—With Nanette Byrnes in New York

Finance Power Players



rewiring huck Prince

Chief hasn't just
been out of Sandy
Weill's shadow—he's
been out of his
as he strives to
redefine himself into a
leader with vision

BY MARA DER HOVANESIAN

ASSUMING THE ROLE of chief executive of the world's largest financial institution in October 2003, didn't come easily to Charles O. Prince III. His natural inclination from day one was to hole up in his office and attend to the company's many pressing matters, just as he had done for almost two decades at Citigroup and its predecessor companies. As general counsel to former CEO Sanford I. "Sandy" Weill, Prince's preference was to blend into the paneled woodwork of his spacious Park Avenue office.

Today, he is a different man. Prince is stepping out of the long shadow of his legendary former boss and pursuing his own strategy. Prince's Citi is selling off units amassed over the years, bolstering its retail banking operations, and beefing up investment banking overseas. His earliest gestures, which included a supplicating bow to Japanese authorities and the abrupt firing of three high-level Weill loyalists, signaled that he was no longer a Weill apparatchik.

But hard as they were, those steps weren't enough. Prince, now 56, came to recognize that a sprawling company like Citigroup needed more than competence and accountability in the corner office; it needed a charismatic leader. He had no choice but to try filling the bill. "I'm not used to operating in the limelight," he concedes, "but the difficulty of the moment demanded it. I had to get out front and say, 'we're going in this direction, follow me.'"

It has been three years since Weill stunned Wall Street by naming Prince, who had no operational experience save an 18-month stint as head of the investment banking division, as his successor. At the time, little was expected of him, other than to be a loyal caretaker and crisis manager. He took over just as regulatory and public-relations troubles brought on by the collapse of Enron and WorldCom were doing maximum damage to the bank.

One year on the job and billions in legal fines later, Prince had met investors' low expectations, focusing mostly on regulatory matters and failing to become the commander in chief the bank sorely needed.

PRINCE "This is a year for us to execute. It's not a year for excuses"

His main objective at the time: "to keep Citigroup out of the headlines." He was failing

there as well. Two big scandals erupted during his tenure: the Japanese private banking fiasco and charges of illegal European bond trading. And last summer the Federal Reserve, in a severe and unprecedented rebuke, banned Citi from making any future acquisitions until it got its house in order. It was a smack-down not only of the company's business practices, but also Weill's strategy of growth by acquisitions.

Looking back, Prince says he felt like he was flying with no navigation. He heard himself emphasizing to employees that he was in charge and that a plan was on its way. "I may not have known what it was going to be," he concedes, "but I knew it was coming."

Investors, meanwhile, had already soured on the shares of big, complicated conglomerates. Companies like General Electric Co. and Time Warner Inc., with disparate operations and complex structures, couldn't find favor no matter how they performed. Prince's challenge is to prove to investors that Citi isn't too big to grow, and that it can do so without endless acquisitions. So far, they remain skeptical: Citi's stock has underperformed its peers (chart).

Inside Citigroup, Prince must convince the bank's 300,000 employees, who span 100 countries, that he's more than a button-down lawyer, that he has the vision thing. "We're at a very important time for this company," said Sallie L. Krawcheck, Citi's chief financial officer, during a recent call with analysts. "It's important for us to act."

"SUPREMELY CONFIDENT"

PRINCE IS making great efforts to change his management style. He has deliberately distanced himself from the qualities that landed him the job in the first place. His initial approach to leadership was to dictate rules and regulations; now he's fashioning himself a big thinker. He's working on his image, calling on CEOs like Michael S. Dell and Johnson & Johnson's William C. Weldon for advice. He has cut ties with key Citi veterans, cultivating what he calls a "new generation" of leaders. And he is turning away from the Weill strategy of being all things to all customers.

The question is whether it will work. Although Citi is still among the world's most profitable businesses, it's far from the growth company it once was. On Jan. 20, Citi reported fourth-quarter earnings of \$6.9 billion, or \$1.37 per share, two cents below the consensus estimate. Excluding a one-time boost from selling its



“ [Citi is] at a very important time. It’s important for us to act.”

—Sallie Krawcheck, chief financial officer

asset management business last year, fourth-quarter profit fell 3%, to \$4.97 billion. Earnings in its global consumer unit, which accounts for about 55% of the bank’s profits, fell 23%, to \$2.43 billion. Disappointed analysts rushed to cut their 2006 estimates. And some money managers, including Thomas K. Brown, a hedge fund manager with Second Curve Capital, began calling for a breakup of the company, hardly a vote of confidence for the CEO.

In the face of such adversity, Prince is getting out from behind his desk. On Dec. 16 at the annual Citigroup Investor Day, he dispensed with the long-held tradition of department heads making individual presentations. Instead, he emceed the two-hour event himself. “Bad behavior is aberrational,” he told the audience, and although “never is a big word...the chances of [the company] getting into trouble again are virtually nil.” Then he enthusiastically punched the air and declared: “I know where Citigroup is going!” Coming from someone else, a line like that might have been met with snickering. But from the understated Prince, it was reassuring, even inspiring.

“Chuck is trying to introduce a change of culture rather than reinforce a long-held one, and that’s...difficult,” says his friend Weldon. “It’s one thing to talk, it’s another to go out there and make sure it’s reinforced and people understand you’re serious. That’s what [he] has to do.”

Some former staffers aren’t so kind. Prince “wants to emulate Sandy, but he doesn’t have the per-

sonality and charisma,” says a former executive. “Weill has intuition, skill, and ability. He has a steel trap for numbers... Chuck has none of those talents.”

At the Feb. 1 earnings conference call, Prince was as forceful about Citi’s future as he has ever been. This “is a year for us to execute,” he said. “This is not a year for excuses.” He was equally forthright when he spoke to *BusinessWeek*. “I am supremely confident that [our strategy] will work,” he said.

Surprising words from a man stunned to learn he had landed the job in the first place. On the July 4th weekend of 2003, Weill, just back from his annual European vacation, summoned Prince to his home in Upper Saranac Lake, N.Y. “This isn’t good,” Prince thought, figuring that Weill had struck some deal on the trip with the condition that Prince would have to share his job as head of Citi’s investment bank. Prince’s mind spun from anger to resentment to acceptance of his fate. He began making retirement plans, scouring the Internet for houses in Carmel, Calif., and carrying a printout of the listings with him on the plane for review. “I figured, I had enough money. I could deal with this,” he recalls.

A ROCKY START

THINGS WENT differently, of course, and Weill publicly anointed Prince in July, 2003, and he took over two months later. Soon after being tapped for the job, Prince realized how much of a headache

he had inherited. He went public with two main objectives, which proved hindsight to be embarrassingly naïf: get bigger—much, much bigger—stay out of the headlines. “We’re going to be judged on whether we meet that standard or not,” he told analysts.

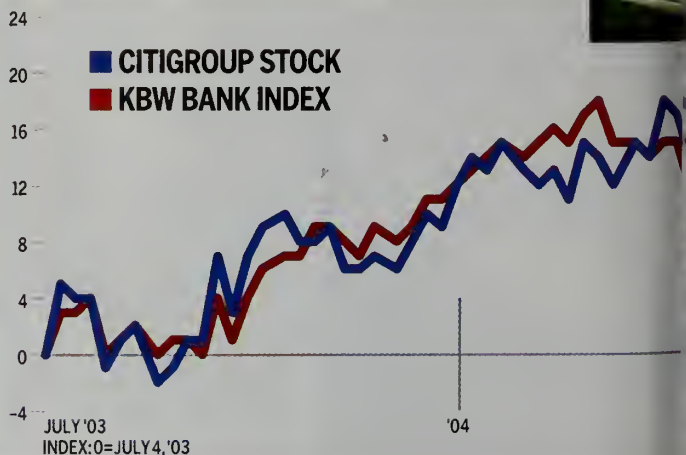
And judged he was. On Aug. 2, Citi’s London-based traders sold billions of European government bonds bought them back at lower prices a matter of minutes, throwing the market in turmoil and agitating Britain’s Financial Services Authority. In June, British regulators fined Citigroup \$100 million for “failing to conduct its business with due skill, care, and diligence.” In September, 2004, Japanese authorities ordered the bank to shut down its private banking operations after an investigation revealed a long list of securities law violations, including lax money-laundering controls. A week later, Prince was before Japanese regulators, accepting their decision and taking responsibility.

Some critics blame Weill and Prince equally for the misdeeds. “This guy was the head lawyer through all this stuff,” says the former executive. “Legal, compliance, risk managers... they all reported to him.”

But others take a more complimentary

Prince and the Revolution

Prince’s tenure has been marked by crisis management. He’s now focusing on growth.



(TOP) PHOTOGRAPH BY NANCY KASZEMAN/ZUMA PRESS; CHART BY ALBERTO MENA/BW

As head of Citi's investment bank, in April, 2003, negotiated a d-breaking \$1.4 billion settlement New York Attorney General Eliot Spitzer, hardly a Wall Street insider, is over Wall Street conflicts of interest, Spitzer says. "The issues went to the of the entire investment banking s," Spitzer says. "It was the busi- model that lay at the root of the m." In Prince, Spitzer says, he saw uality from the start. "He was will- step back and figure out the strate- pact of the settlement on the busi- rather than focus on the complaint," Spitzer says. "He confronted the

alist, he was reluctant to embrace change or make unpopular decisions.

That first break is a deer-in-the-head- lights moment for many new CEOs. How well they respond in the early days can shape perceptions for years to come. Investors "are looking up to you for clarity of communication, logic of the strategy, and laser execution," says Home Depot CEO Robert L. Nardelli, another of Prince's mentors. "I know; I've been through transitions myself."

WEILL'S BLESSING

PRINCE MAY NOT have had a plan, but he wasn't afraid to act. In his first month, he summoned Thomas W. Jones, chair-

for a clean-up. No one would take responsibility. So Prince fired all three on the spot, a move that would have seemed unimaginable even a few months earlier.

The bold action opened eyes. "Chuck Prince has extended accountability from numbers to behavior," says Howard K.

He confronted the tough issues and acted...like a CEO

—Eliot Spitzer, New York Attorney General

issues and acted more like a CEO and general counsel."

Prince knew early on that his biggest sh would be to distance the company from its past, without wrecking the 200- legacy of the institution or under- mining morale. That meant he needed to har the impression that, as a Weill loy-

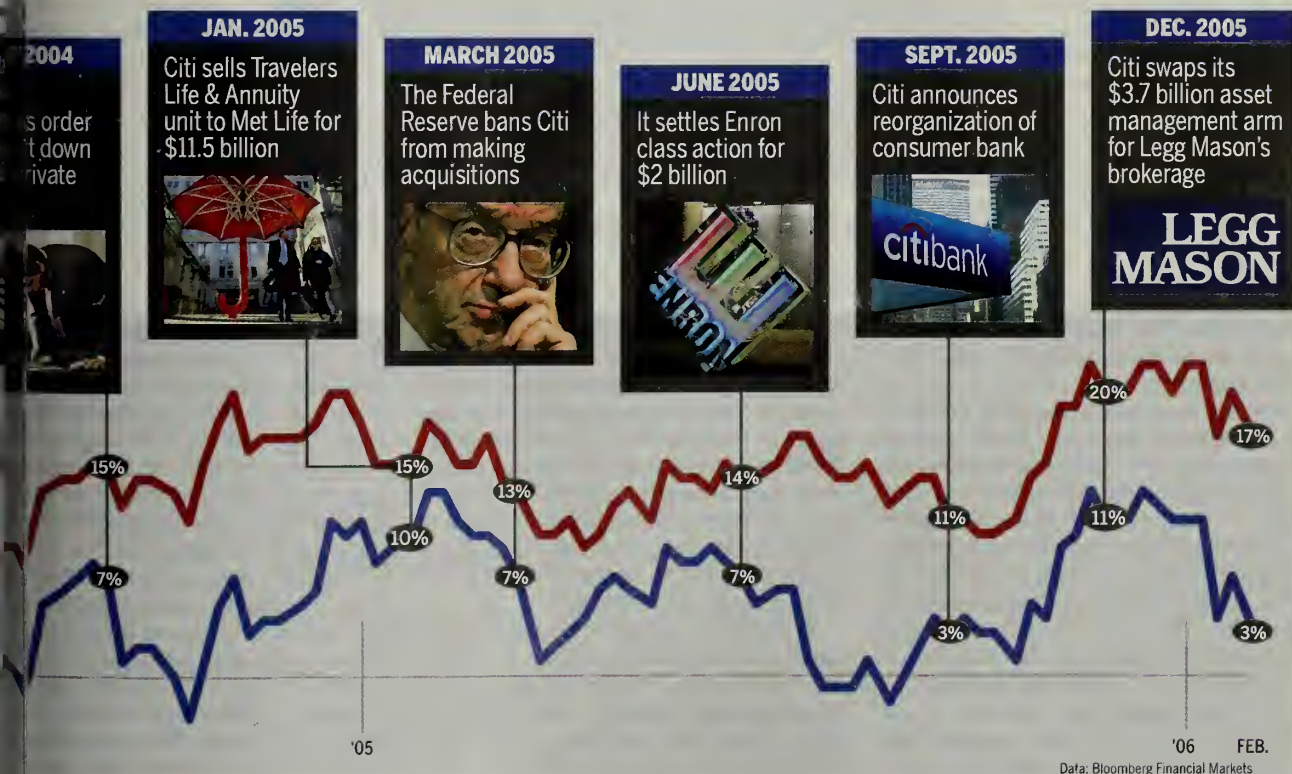
man and CEO of Global Investment Man- agement & Citigroup Asset Manage- ment; Deryck Maughan, vice-chairman and CEO of Citigroup International; and Peter K. Scaturro, CEO of Citigroup Pri- vate Bank. He wanted to know why the scandals in Japan had happened and why they hadn't yet met regulators' demands

Mason, senior financial analyst at Sanford Bernstein & Co., a research shop in New York. It was a watershed in his transfor- mation of the Citi culture.

Then, on March 1, 2005, operation charisma began. Prince launched his "five-point plan," which included new standards for training, development,



(TOP) PHOTOGRAPHS BY STEPHEN CHERNIN/GETTY IMAGES; (BOTTOM L TO R) HEATHER HALL/AFP/GETTY IMAGES; YURIKO NAKAO/REUTERS; TRAVIS LINDQUIST/GETTY IMAGES; MARK WILSON/GETTY IMAGES; JAMES NIELSEN/GETTY IMAGES; JENNIFER S. ALTMAN/BLOOMBERG NEWS



Finance Power Players

compensation, and annual reviews, all designed to inspire and monitor good behavior. Citi created a slick DVD sent to employees and journalists around the globe. Within two months, Prince personally addressed some 45,000 employees in 11 town hall meetings in 10 countries.

He has since taken bolder actions. In a rejection of the strategy that created Citi, Prince sold off its asset management and life insurance units last year. Under Weill, Citi was the most prolific acquirer U.S. finance has ever seen. Prince and his new team hope to create a more organic model. "One has to realize that the world is always changing," says Weill, who supports Prince's strategy. "The point is not to put your head in the sand. You must lead the change or at least respond to it."

Prince says that under his plan, growth will be internal, coming primarily from international markets. He calls Citi "a distribution company now," selling products like mutual funds, stocks, and investing advice across its vast network. He plans to invest in technology and training to link more closely the bank's brokers and bankers so they push more financial products and advice. The goal is to make more profits from each customer.

Prince aims to tap into Citi's key competitive advantages: its brand and its scale. His goal is to expand its consumer business from 53 countries to all 100 where Citi operates. In investment banking, he's targeting cross-boarder mergers and acquisitions. He plans to upgrade Citi Financial, the consumer finance unit, and go after the "newly affluent" with \$100,000 or more in assets. And he will combine Smith Barney brokers and Citi retail branches at some test sites.

This was vision born of necessity. "The most successful CEO successions are not only when the person was completely dif-



“ One has to realize that the world is always changing. The point is not to put your head in the sand.”

—Sandy Weill

ferent, but the era was changing, and to make that distinction was critical to the success of the company,” says Kathryn B. Williams, chair of KRW International, a New York senior-executive development firm. The transition from Harvey Golub to Kenneth Chenault at American Express Co. or Jack Welch to Jeff Immelt at GE come to mind, says Williams.

Prince says inertia is his biggest obstacle. “I have to be able to inspire people, to motivate people,” he says. “That’s my job. It cuts against traditional patterns of doing business, it’s new, and it feels awkward at first.”

But there are more concrete chal-

A WATCHFUL EYE Weill the inauguration of Citibank's Shanghai Tower, Sept. 27, 2004

lenges. The bank has fared a brain drain the exits of such prominent figures as former No. 2, Robert B. Wilstad, and Marge Mader, former head of the global consumer business. Under Prince, Citi has lost some high-profile executives such as James D. Wolfensohn, the former World Bank head who is now a senior adviser for international expansion plans. But more talent has left than arrived.

Prince quipped at a Citi financial services conference on Feb. 2 that “the people who used to work for Citi are at Morgan now.” A former board member says the future may hinge on personnel: “It’s all about leadership and the talent you can attract.”

Prince says the key requirement of a successor is to accept change. He’s reminded of that by: In his office sits a box with a replica of a commercial shipping vessel that once graced the office of legendary banker and former Citibank CEO Walter Wriston, who died last year at age 85. Wriston was in charge during the 1970s, when shipping was the bank’s

largest revenue source. Today Citi doesn’t even have a shipping finance department. Says Prince: “If you think we’ve changed the consumer business and the world has come to an end, remember that the bank that Walter ran years ago has disappeared.”

Prince’s maneuvers have been met with hostility by some employees and skepticism by investors. But his transformation is gaining traction. He had to do a fair amount of restructuring, says Robert Druskin, head of Citi’s corporate and investment bank. Prince “shows more confidence these days. He has gotten into this job.” ■

B-School Turf Wars

Smaller programs are under siege as
top-tier universities expand their reach

ANDSEY GERDES

IT WAS A LITTLE LIKE BEING A mom-and-pop grocer and finding out that Wal-Mart was opening a Supercenter down the block. When Rice University and Texas A&M University learned that the University of Texas at Austin planned to launch a part-time B-school program on Houston turf, they were less than amused. The war of words that followed was the academic equivalent of a steel mill match, with both local programs begging the state to look into the matter and pointing out UT's plans in the *Houston Chronicle*.

Why no Longhorn love? "We're such a powerful brand name," says Larry Abeln, state dean and director of executive education at UT's McCombs School of Business. "It's natural that others felt we could be a threat in the marketplace."

These days no B-school's fiefdom is secure. It used to be that even mid-tier programs in thriving business hubs such as Miami, Portland, Houston, and San Francisco had plenty of local managers to fill their part-time and executive B. (EMBA) programs. Now top-tier programs such as Kellogg, Wharton, Cornell and Columbia are making aggressive moves into these promising new markets with a brand of B-school imperialism that may well cause casualties in its wake.

The rush to expand programs as the EMBA market begins to show signs of weakening. During the current drought in applications to full-time programs, many schools have even offered to accept non-business professionals, as a last resort. But now even

Lesser-known locals have to get creative to challenge the invaders



EMBA application growth is slowing. Many programs are looking for expansion opportunities far from home, and that sometimes means going head-to-head with local providers.

But as UT found out, that is not always as simple as it sounds. As big-name programs move into new markets, lesser-known local programs are trying to fend off these competitors by making internal improvements, stepping up marketing efforts, or expanding their own offerings. After the UT program in Houston opened in August with 115 students—twice as many as UT expected—Rice finalized plans to challenge the invaders by launching its first-ever part-time program in July.

In Portland, Ore., where Wellesley (Mass.)-based Babson College will begin offering classes later this year, the reaction has been equally swift. The University of Oregon, Portland State, and Oregon State, which offer a combined EMBA, have hired a marketing firm to get the word out about the advantages of a homegrown education, including access to the combined faculties of three schools. Later this month they're moving the program to a new downtown Portland facility featuring cutting-edge wireless technology and classroom space with stadium seating designed specifically to teach case studies. "We haven't served the market as aggressively as we might have," admits University of Oregon B-school Dean Jim Bean. "We're changing the rules of engagement."

PARTNER UP

WHEN THE BIG boys swoop into promising markets, they sometimes open new campuses, as Wharton did in San Francisco in 2001 to tap into the tech industry in Silicon Valley, and as Kellogg did in Miami in January to access the Latin American markets. But more often than not the ideal political solution is to partner with a local provider in the target region to blunt opposition to the move.

Such a strategy has academic benefits, too, giving students access to two sets of faculty and two alumni networks.

Columbia Business School in New York teamed up with the University of California at Berkeley to offer a West Coast-based EMBA program in 2002, while Cornell University in Ithaca, N.Y., partnered with Queens University in Kingston, Ont., opening a distance learning program in June. The program entails three on-campus sessions and interactive broadcasts to 10 locations in New York and Canada three times a month. It's a model Cornell believes would work well in many markets, so the school is actively scouting locations. Says program director Danny Szpiro: "There are people everywhere who would like to do an MBA with Cornell."

That's an edge few brand-name programs would be willing to ignore. As the race to capture qualified candidates intensifies, many lesser-known players that thought they dominated the local market may be in for a surprise. ■

Meet My Teachers: Mom and Dad

A growing number of affluent parents think they can do better than any school

BY MICHELLE CONLIN

SLATER ALDRICH DOESN'T attend any of the top-shelf public or private schools near his family's Madison (Conn.) home, not even his mother's alma mater, the \$18,000-a-year Country School. Instead, the 11-year-old spends his days playing the role of town zoning officer, researching the pros and cons of granting approval to a new Wal-Mart. Other endeavors include pretending he's a Sand Hill Road venture capitalist, creating Excel-studded business plans for a backyard sheep company, and growing his own organic food. "It's kind of like living on a white-collar farm," says his dad, Clark Aldrich. Aldrich vowed he'd never put his kid through the eye-glazing lectures he endured in school, even at prestigious institutions like Lawrence Academy and Brown University.

Like a growing number of creative-

class parents, the Aldriches homeschool Slater, splitting the duties. (Aldrich *père*, who co-founded interactive learning company SimuLearn, handles math and science; his wife, Lisa, a stay-at-home mom, does the reading and writing. Slater's friends come over after school and on the weekends for pickup games.)

No longer the bailiwick of religious fundamentalists or neo-hippies looking to go off the cultural grid, homeschooling is a growing trend among the educated elite. More parents believe that even the best-endowed schools are in an Old Economy death grip in which kids are learning passively when they should be learning actively, especially if they want an edge in the global knowledge economy. "A lot of families are looking at what's happening in public or private school and saying, 'You know what? I could do better, and I'd like to be a bigger part of my kid's life,'" says University of Illinois education professor Christopher Lubienski.



THE MILES-MORILLOS
Mom Lynne says her oldest son "begged" her to homeschool him

The spread of the post-geographic style and flex-time economy, in which managers can work at odd hours in a number of locations, is also playing a role. So is the fact that more knowledge workers want to live in more than one place. Homeschooling can untether families from geographic codes and school districts, just as the Internet can de-link kids from classroom

pipelines. Economics tutored from the Federal Reserve's online tours of Florence's Uffizi Gallery, ornithology seminars from Cornell University, and filmmaking classes from UCLA stream onto laptops and handhelds. Also driving the trend is a new cottage industry of private tutoring, cyber communities, and curriculum providers. Parental co-ops. Popular online sites range from humanities tutoring at ment.neh.gov to the free lifeofflorida.org would have been impossible to homeschool little 20 years ago."

PLAYBOOK: BEST-PRACTICE IDEAS

If You Want to Homeschool...



It isn't just for the ultrareligious. More creative-class parents feel it's the best way to prepare their kids for the global economy. A few tips:

Data: www.lifeofflorida.org

BE PERPETUALLY CURIOUS

That will set the model for your children. Use your librarian, museum curators, a symphony conductor.

GOOGLE IT

The Internet opens up the world as a classroom.

BECOME YOUR CHILD'S LEARNING COACH

Cooking dinner can be project management. Chess can be math. Yardwork can be science.

DON'T OVERCOMMIT

Teach your children time management.

KEEP UP THE CONVERSATION

Talking is the most valuable aspect of any learning environment.



ed Florida, author of *The Flight of the*
Class.

Internet is a chief resource that's
ing homeschooling's growth, from
00 children in 1999 to more than
million today, according to the U.S.
tion Dept. The popular perception
people homeschool for religious
is. But the No.1 motivation, re-
shows, is concern about school
nments, including negative peer
ure, safety, and drugs. In some cir-
homeschooling is even attaining a
ution as a secret weapon for Ivy
age admission.

Homeschooling is also more promi-
nt in the popular culture, which is help-
de-stigmatize the choice and lend it
cachet among kids and their par-
ts. The near-perfect SAT-scoring Scot, a
nt tant on last year's ABC reality show
cholar, was homeschooled. Home-
urs have long swept the national
g and geography bees. This year
\$50,000 prize awarded by the famed
Westinghouse Competition
no homeschooled 16-year-old math-
ician Michael Viscardi.

Viscardi's neuroscientist mother and
gier father pulled him out of the

tony, oxford-and-shorts
private school St. Mark's
in Dallas because admin-
istrators wouldn't accel-
erate Viscardi in math,
even though he was do-
ing high school-level
work in the fourth grade.
Michael's mother, Eunjee
Viscardi, says Michael
initiated most of his own
learning. The challenge
was dealing with her
fears that she was ruin-
ing his life by isolating him, something he
countered with heavy involvement in the
community youth orchestra. "It was
nerve-racking because we're all brain-
washed to believe that our children have
to be in school," she says. Those concerns
have since faded; Michael is set to enter
Harvard University this fall.

One popular critique of conventional
education likens it to a mass-production
institution that is failing to adapt.
Schools, critics say, are like old industrial
assembly lines, churning out conformists
who could function well in rote factory
jobs or rigid corporate hierarchies but not
in New Economy professions that de-

mand innovation and independent think-
ing. Indeed, the Education Dept. states in
a report that the most promising learning
developments, such as e-learning and vir-
tual schools, are occurring outside the
system. "Almost everyone is thinking
about how schools aren't the right insti-
tutions anymore," says Florida.

PATCHWORK OF LAWS

HOMESCHOOLING ISN'T universally
applauded as a solution, however. Some
parents and educators worry that it re-
tards children's socialization. Others say
it siphons much-needed resources like
per-pupil funding and the activism of the
most savvy parents. Schooling in isola-
tion could threaten civic cohesion and di-
versity of thought, says Stanford Univer-
sity education professor Rob Reich.
Reich favors stricter homeschooling reg-
ulations to supplant the current patch-
work of state laws so that children can be
assured of exposure to more than just
what their parents sanction. He also wor-
ries about parents pushing homeschool-
ing on their kids.

But in some cases it's not the parents
who are doing the pushing. Lynne Miles-
Morillo, a mother of three, taught herself
Russian in high school so she could read
Dostoevsky in the original. ("It's totally
different, you wouldn't believe.") She
graduated from Bryn Mawr College and

married Robert, a Har-
vard-educated Rhodes
scholar who is now a
history professor at
Wabash College in
Crawfordsville, Ind. A
year ago, Miles-Moril-
lo's oldest son begged
her to homeschool him.
He was bored in class
and didn't share the
conservative views of
most of the other kids.

She agreed to try it out

on her two older children, and if they
didn't all hate one another by the end of
the month, they could continue. "I don't
have that inner Buddha inside of me,"
says Miles-Morillo.

What surprised her was how lovely it
was for the family to create its own edu-
cational rituals. The biggest misnomer is
the word home since the family travels all
over, from the Smithsonian Institution in
Washington to Chicago's Museum of Sci-
ence & Industry to the world's most active
volcano in Hawaii. Morillo's fear was that
homeschooling would make her kids'
world smaller. But instead, she says, "it's
opening it up more." ■

Peer pressure, drugs, and safety concerns are also key forces behind the trend

Dr. Warren's Lonely Hearts Club

EHarmony sheds its mom-and-pop structure, setting the stage for an IPO



BY CHRISTOPHER PALMERI

DR. NEIL CLARK WARREN wasn't the first to try matching the love online. "We were 3,000th," jokes the 61-year-old founder and chairman of eHarmony Inc. But back in 2000, Warren, a University of Chicago-trained psychologist who had counseled couples for decades, wanted to play matchmaker himself. Other sites let serial daters post their listings. Warren created a minute-long personality quiz that made matches based on the answers. The site doesn't encourage direct communication until after the would-be lovebirds respond to even more queries. "We love it that on our site, guys have to answer 436 questions," he says.

Warren's lonely hearts club club. EHarmony is now celebrating its 10th year, with traffic on its site rising to 1.3 million visitors, according to Nielsen//NetRatings. Subscribers pay up to \$59 a month for the service, which Warren claims resulted in 100 marriages last year, based on a Harrisburg survey conducted on eHarmony's behalf. Warren—gray-haired, neatly dressed, and spoken—has become a familiar and comforting presence on radio and television, thanks to eHarmony's \$100 million annual advertising budget. He was even lampooned on *Saturday Night Live* last year in a skit about a dating site for narcissists called Me-Harmony.

Now, though, other dating sites are taking a similar approach to wooing the lovelorn. Dating industry leader Yahoo! Inc. Personals has also developed personality tests that put like-minded men together. And IAC/InterActiveCorp's Match.com is offering dating advice from TV's Dr. Phil McGraw. Warren declined to provide information about the site's financial health. But the increasing competition comes as growth in the \$1-billion-a-year online dating industry has slowed to 6% from 70% just a few years ago. "It's a sign of maturity in the category," says Nate Elliott, online research analyst at Internet research firm JupiterResearch. "The curiosity factor is mostly gone."

And with that initial infatuation

DREAM TEAM

Warren and his new CEO, Jaynie Studenmund, have similar backgrounds

Warren is hoping to take his relationship with eHarmony members to the next level. On Feb. 1, he introduced a new online service

l to help married cou-
stay that way. He also
d some family ties at
company. Last year, his
of 47 years, Marilyn,
up day-to-day duties
d of public relations.
emains a consultant.

n Feb. 1, Warren's son-in-
d eHarmony co-founder Greg For-
47, stepped down as chief execu-
though he will serve on the board
ectors. Everyone involved says the
tures were amicable.

ST RULES

NG THOSE BREAKS is necessary,
n says, if eHarmony is to reach its
potential. His plans include an as yet
cheduled initial public offering to pro-
ounds for international expansion
he launch of new products such as
eling for parents. Besides, he says,
ng with relatives can be a struggle
n the most well-adjusted companies.
ning a family business isn't the easi-
ing," he says. "When you're locked
every day, you don't want to get to-
socially anymore." Adds Forgatch,
ays leaving eHarmony was his idea:

"I got my father-in-law back."

The two had been working
together since 1995, when they
started a business selling audio
and video tapes based on War-
ren's experience as a marriage
counselor. They eventually
transformed the company into
eHarmony. Warren, a devout
Christian, initially promoted the site on
fundamentalist James Dobson's radio
show, but broke with Dobson last year be-
cause he felt Dobson's Focus on the Fam-
ily organization had become too political.

Warren has always had to dodge criti-
cism that his site is designed to promote

evangelical Christianity. Critics
contend that he doesn't make many
matches for those who profess oth-
er faiths. He denies those claims.

A couple of years ago, one dis-
gruntled visitor to the site
went on *Good Morning
America* and complained
that he had been rejected by
eHarmony because he
wasn't spiritual enough.
Warren says that he took
one look at the guy's body
language and concluded
that he was depressed,
which would explain why he
flunked the personality quiz.

Warren is not a big believer
in the idea that opposites
attract (even if they do, he
argues, they won't last). As a
marriage counselor, he says
he performed hundreds of
"autopsies" on failed relationships and
realized that most of the people didn't
belong together in the first place. So
eHarmony's compatibility questionnaire
tries to determine where a potential
match rates on no fewer than 29 differ-
ent personality traits, including kind-

**Warren
doesn't
believe
that
opposites
attract**



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ness, intellect, curiosity, humor, energy level, and sexual passion.

Warren also imposes strict rules on eHarmony. No one under 21 can join, because marriages between younger people are twice as likely to fail, he says. Nor will he allow people on his site who have been divorced more than three times. Warren won't match taller women with shorter men, because he believes that's a difference difficult to overcome in a relationship. And, most controversially, he won't fix up same-sex couples; he finds the issue too divisive.

EHarmony's new service is what Warren calls a "marriage wellness program." Each spouse completes a 310-question quiz designed to determine the relationship's strengths and weaknesses. The course, which costs \$239 per couple, includes 20-minute follow-up exercises. Warren says that when he and Marilyn

Executive "Rules"

How do high-powered executives' marriages stay strong? We asked a few for their advice on how to keep relationships healthy.



“We've traveled to 75 countries. The trips are what I call 'marriage protection'”

Aylwin Lewis, chief executive, Sears, who has been married to Noveline Lewis for 22 years



“Spontaneity, surprises, sitting down for breakfast together and never going to bed angry”

Mireille Guiliano, chief executive, Clicquot Inc., has been married to Edward Guiliano for 30 years



“She goes with me whenever my assignments happen. It's a hectic way of life, but it's kept our 40-year marriage intact”

Steve Miller, turnaround expert and husband to Maggie Miller



“Never stop dating each other”

Bill Gross, chief investment officer, PIMCO, who has been married to Sue Gross for 20 years

51, a former senior executive at Pa Bills.com Inc. Overture Services, he was sure would be a good bination. Why? had so much in common, from their grounds to the involvement with families. “She’s bred,” he says. “both from Iowa dad was a senator

Although he originally considered Studenmund for on eHarmony’s of directors, he was smitten that he offered her the chief executive job instead. But was committed spending more with her children

took the test, he found out that she didn’t think he shared all his feelings with her. “After 47 years of marriage, how come I didn’t know that?” he asks.

Warren has even put his relationship theory to work in the corporate world. When he first met Jaynie M. Studenmund,

turned him down twice. Finally, a 3½-hour breakfast meeting where Warren offered to let her work flexibly, Studenmund changed her mind and yes. She started her new position on 1. So far, says Warren, “she and along beautifully.” ■

MATCHMAKING

Must Love Wing Tips

We figured that asking single executives to talk about their love lives would be a frustrating, probably futile pursuit. We might as well be inquiring about their mental health. So we turned to several online matchmaking sites to get the lowdown on what the lonely hearts in the executive suite secretly yearn for.

To start with, more than a third of all online daters are over 45, and 19% make more than \$100,000 a year, says Web tracking firm Hitwise. Industry pioneer Match.com reports that 7% of its 8 million members call themselves executives (while the government classifies 4% of the workforce as managers).

They’re more likely to be divorced (36%), have dogs (30%), and enjoy wine tastings (20%) than other singles. They tend to list

their eyes as their best feature—in marked contrast to, say, the nonexecutive singles of Grand Rapids, Mich., where the largest group (5.8%) cites their butts. Manhattan has the highest percentage of execs (29%) who find power a turn-on; Las Vegas has the biggest share (22%) who say money is. Colorado Springs has the most who are turned off by power and money.

In Washington, D.C., the women have high financial expectations: 44.3% of female executives want a match who makes more than \$150,000. In Raleigh, N.C., it’s the men who do: 37.2% of the male executives there want a date who rakes in that much.

Executives are sexually adventurous. True.com, a fast-

growing matchmaking site, offers a sexual compatibility quiz that puts people into one of eight categories, from “traditionalists” to “mavericks.” Sixteen percent of executive members are mavericks, vs. 12% overall. “They’re willing to do just about anything,” says True.com founder Herb Vest, “within the normal parameters.”

And yes, older men want younger women. Match.com says male execs in L.A. typically seek women 13 years younger. About 25% of eHarmony.com’s men over 40 are interested in women 40 or younger. TI

can put founder Dr. Neil Clark Warren in the awkward spot of having to explain to some men that younger women just aren’t into them. “I’ve had men ask: ‘Do they know what worth?’” he says.

They can take heart: Palm Bay, Fla., has the highest percentage (7%) of women seeking bald men

—By Christopher Palm in Los Angeles



Executives tend to list eyes as their best feature



Spinoff that acted like a startup.

Avaya, a global leader in communication software, systems and services, spun off from Lucent with a legacy infrastructure that, while efficient, wasn't nimble enough to create a competitive advantage. HP partnered with Avaya to implement IT Service Management and HP OpenView, effectively re-deploying existing technology assets. Today, spending is down 30%. Millions have been saved by using unused capacity. And Avaya answers whenever opportunity calls. www.hp.com/adapt

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Montana Mountain High

Two neighboring ski resorts, Yellowstone Club and Moonlight Basin, boast multimillion-dollar homes, no lift lines, and lots of powder. **BY STANLEY HOLMES**

THE FANTASY BEGAN WHEN I pulled up to the base of the Yellowstone Club, an hour south of Bozeman, Mont. The concierge staff took my keys, my boot bag, and my skis. Then they parked the car, unzipped my ski bag, placed my skis on the snow near the lodge, and planted a pole on either side. All I needed to do once I was ready to hit the slopes was step into the bindings and go the short, flat distance to the nearly empty chairlift. As I watched the staffers lay out my gear, I thought to myself: "Those guys are crazy! Somebody's going to steal my skis."

Unlike the ski areas I typically frequent, however, theft is not a worry at the Yellowstone Club. Nor are lift lines or lack of powder. Of course, you do need a minimum of \$3.5 million in net worth and an invitation to join. The fees break down into a \$250,000 initiation charge and \$16,000 in annual dues. Plus, you're required to buy a homesite for \$1.1 million to \$3.2 million, and eventually you have to build a house. One original owner recently sold his property and chalet for \$12 million. For the price, members of this 14,000-acre club and their lucky guests get a ski experience most people only dream about.

Well, you might come close at the majestic Moonlight Basin Resort, just 10 miles up the valley. Moonlight Basin, which shares a knife-edge ridge with the popular Big Sky Resort, offers high-end amenities similar to Yellowstone Club's. But there are some big differences: The

terrain is more challenging, it sells condos and cabins as well as \$1 million slopeside properties, and it's open to one who buys a \$40 lift ticket.

Neither resort follows existing models. Yellowstone Club comes closest to a exclusive private golf community, but one else has included a massive ski area as part of the package because of the capital and operating costs. Moonlight began as a real estate venture in 1999, opened its ski area in 2003. From One, its purpose was to preserve as much of the environment as possible. Moonlight attracts the same kind of serious skiers as Telluride and Aspen, Colorado, and Whistler in British Columbia. But it's authentic Montana all the way, from steep powdery slopes and superb tree skiing to the lodge that boasts a two-high stone fireplace with stuffed mountain goats perched along the side.

When I visited Yellowstone Club in January, a clear blue sky and 15-degree temperature greeted me, along with Hank Kashiwa, director of marketing, a former pro ski racer. As we set off, it came immediately apparent we have the mountain virtually to ourselves.

ROLLING RUNS

MOST OF THE FRONT face is marked by rolling, intermediate-level runs, known as "groomers," that are fun to ski. But the real pleasure is on the back side, where Kashiwa took me to some powder. At one point on a run called N



BACK COUNTRY FUN
Untracked snow at
Yellowstone Club

(L TO R) TRAVIS ANDERSON; COURTESY MOONLIGHT BASIN

IN THIS SECTION:

A checkup of insurer health sites

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91 A science project that studies fund managers

92 PLUS: How deductible is that donation?



LOCAL COLOR
Moonlight Basin's lodge with its two-story fireplace

ing, we stopped to catch our breath, continued down until we burst through the last thicket of trees and floated through untracked snow.

Moonstone Club is the fantasy-dream of billionaire timber and real estate baron Tim Blixseth and his wife, Edra. The couple established the club in 2000 in a land swap with the federal government. So far, only 20% of the property has been developed. The club supports a golf course designed by renowned pro golfer Tom Weiskopf. It funds its own fire district that houses three gleaming trucks, and the head of security was a former secret service agent to former President Gerald Ford.

The club plans to cap memberships at 64 homesites. So far, there are 250 members, including Microsoft founder Bill Gates, former Vice-President Dan

Quayle, and ski film pioneer Warren Miller, for whom the club's epicenter, a massive timber frame lodge, is named. The food at its three restaurants is five-star quality. I especially liked the cauliflower soup and glazed elk.

Moonlight Basin is a more accessible fantasy. The resort has been a labor of love for local owner Lee Poole, who with investors purchased the Moonlight Basin Ranch 14 years ago. "Our vision was to protect as much property as we could through conservation buyers," Poole says. The land sits on the north side of the 11,166-foot Lone Peak, looking out into the majestic Lee Metcalf Wilderness area. On a clear night the

To join Yellowstone, you need a net worth of at least \$3.5 million

cabins are bathed in the shimmering light of a moon that seems so near you can touch it with a ski pole. It might as well be a world away from the hustle and bustle of Big Sky on Lone Peak's south side.

The mountain's skiable area, 1,650 acres served by six chairlifts, is rather modest by major ski area standards. What it lacks in size, it

makes up for in skiing quality. The lower half of the mountain is full of long, intermediate runs sprinkled with some serpentine tree skiing. The top half is carved out by the fearsome Headwaters, a towering cirque of heart-pumping chutes bearing names like Don't Tell Mama and Hell Roaring.

The Headwaters elevates Moonlight Basin into that rare group of lift-served playgrounds for hard-core skiers. Ski areas have been opening up more such challenging terrain in response to growing demand. This winter Moonlight Basin and Big Sky are offering a Lone Peak Pass that provides access to 5,300 acres of skiable terrain across both resorts and a mighty 4,350 vertical feet of skiing. Big Sky skiers can sample the Headwaters, and Moonlight Basin patrons can drop over the ridge and take Big Sky's Lone Peak Tram. From the top, they can plunge down the seriously steep North Summit Snowfield back to Moonlight or try their luck on Big Sky's precipitous Dictator Chutes.

WINDS OF HELL

ON MY LAST DAY, high winds prevented me from making it up the Lone Peak Tram, so I tried more of the 16 Headwaters chutes. After riding the short Headwaters chair, I hiked the ridge to the entrance of Hell Roaring. With the winds



still blowing and a light snow falling, I stared down at the yawning void. I had only one modestly flat spot to click on my skis, and I had to do it carefully or risk losing them. Falling was not an option. A tumble would likely mean colliding into the flesh-scraping andesite that bordered the narrow runnel I was about to descend.

Once I took off, the snow was so soft that any fears of a bone-jarring fall evaporated. It was just one sweet turn after another, baby, until my thighs screamed for me to stop. I met my partner for the day, Moonlight's marketing director, Rich Hohne, who was waiting at the bottom of the gully. We looked at each other and grinned. There was nothing more we needed to say. ■

How Good Is Your Online Nurse?

A checkup of insurer sites that offer personalized advice to plan members. **BY ARLENE WEINTRAUB**

HEALTH INSURERS have launched all-out campaigns to get their members healthy. It's no wonder: Prescription drug, hospital, and other health costs continue to grow at double-digit rates, and your medical plan doesn't want to get saddled with all those bills. That's especially true for illnesses you might have avoided, such as diabetes and chronic heart disease, had you spent more time walking on the treadmill rather than raiding the refrigerator. So in the past few months the major insurers have started reaching out to patients via the Internet, offering a plethora of tools designed to help them better manage their health.

With the cooperation of the three largest insurers—WellPoint, UnitedHealth Group, and Aetna—I logged on to these patient portals to see how they're shaping up. Until recently you couldn't find much on your insurer's Web site beyond your benefits details, physician directories, and hospital comparison tools.

Now insurers' sites are getting personal. They're taking information you provide and fashioning a specific set of interactive tools for managing everything from high cholesterol to cancer. While the sites aren't yet fully integrated, say, with prescription plans, they're off to a good start. A handful of insurance plans are making some of their handiest tools available to nonmembers, too.

I found the richest set of offerings at Aetna's site (aetnanavigator.com). I started by filling out a five-minute health assessment, which fired off four pages of questions about my disease history, recent test results, and overall well-being. The other companies' sites include similar questionnaires, but Aetna's was the most comprehensive, with questions

ranging from "How often do you use 15 sunscreen when you're spending hour in the sun?" to "Rate how much stress you have in your life and how you handle it." As soon as I finished site informed me that I have a chance of developing five serious health problems, including heart disease and stroke. That's largely because my cholesterol level is over 200.

CUSTOMIZED PORTAL

THEN AETNA'S SITE got really good: It cooked up a home page just for me, with links to sub-sites that could help me design my own cholesterol-lowering regimen and track my progress over time. My favorite was Simple Steps to a Healthier Life (simplestepslife.com), which offered several tailored, six-week programs focusing on specific goals. In Week One of the "healthy heart" program, the site asked me about my dietary preferences, exercise routine, and other details. Then it spat out a seven-day meal plan, complete with recipe and calorie counts, and even snack suggestions. For an extra \$19.95, I could get a written report from a dietitian offering an assessment of my eating habits, and for \$79, I could get a phone consultation.

Following close behind Aetna is UnitedHealth's site, which is the nation's largest health insurer, and WellPoint, which serves 34 million patients mainly through its Blue Cross Blue Shield and Anthem Insurance subsidiaries. WellPoint's sites are powered by WebMD Health, which has been providing health information to consumers since 1998. Using the information from patients' own health assessments, WellPoint sifts through WebMD's library of 20,000 articles and links to the ones that pertain to their health conditions and goals. There's a host of interactive tools, including the Lifetime I



Adherence Program (LEAP), which lets you design a fitness program and tracks your progress over 13 weeks. Like many of the WebMD-backed tools, LEAP adapts itself over time based on each user's health profile and the information they've provided about progress. So if you start to slack off, it might send you a message to motivate you to stick with your exercise plan.

Both Aetna and WellPoint offer scaled-down versions of their member sites to nonmembers. Visitors to WellPoint's public portal (accessible via anthem.com) can access articles from the famous Cleveland Clinic and sign up for e-mail newsletters on topics such as allergies, diabetes, and blood pressure. Aetna's intelhealth.com picks up publications from Harvard Medical School. Another Aetna site, myforyourhealth.com, educates con-

sumers about how to shop for health benefits at various stages of life. The all-access sites give you a taste of how the companies interact with patients via the Web. That insight could help you pick a plan during the next open enrollment season.

Among the big three insurers, UnitedHealth's site is the one that could use a serious remodeling. I found its member site (myuhc.com) messy and difficult to navigate. Even though I filled out a health assessment before I got started, United didn't seem to incorporate some of my answers into the tools it placed on my personal portal. As I revealed in my questionnaire, I've never smoked. Yet my

menu of personal health tools included one for tracking my cigarette use.

The tools I did use weren't practical. For example, I was able to log how many hours I slept each night, but United didn't link my data to details about how my slumber habits affect my general health. When the company did provide health information, it often kicked me over to external Web sites. I got a message urging me to "consider working physical activity into my daily life," but when I clicked on "more information" I landed on the site of the American Heart Assn. (americanheart.org). All in all, my portal on United's site felt more impersonal than personalized.

HOSPITAL SEARCH

UNITED DOES EXCEL in older tools, such as its hospital comparison engine. When you search for a hospital near your home, you're presented with a list noting each facility's specialty and how it rates on quality. The company plans to build cost details into the engine as well. So if you're planning to undergo heart surgery, you can search for a hospital that's reasonably priced and that has been designated a "UnitedHealth Premium Program for Cardiac Care"—meaning it offers the greatest depth of experience.

Granted, the three plan providers all have their work cut out for them. None is as tightly integrated with its members' health records as it could be. For example, if you receive health benefits and prescriptions from different providers, you can program your health plan portal to remind you when it's time to order a refill by mail. But you will probably have to click to another Web site to place the order.

Officials at the leading plans say they intend to boost their integration features. For some, that includes building systems to feed blood test results and other records directly into personal health assessments. Then you won't have to remember, say, what your good and bad cholesterol levels are. Your portal will find out and adjust the tools it offers you accordingly. A bit like Big Brother? Sure. But as health care gets more complex, it's comforting to have a virtual coach. ■

A drawback: Some sites don't have links to prescription plans—yet

Taking the Temperature

Health plans are enhancing their menus of online tools for members. We performed a physical on the vitals of the three biggest insurers. Here's how they stacked up:

Provider WellPoint
Members 34 million
Site anthem.com*

The Bottom Line With a robust engine powered by WebMD, this triad of Anthem and Blue Cross plans excels at delivering vast amounts of personalized health tips, some of which are also available to nonmembers

Provider UnitedHealth
Members 18 million
Site myuhc.com

The Bottom Line Heavy reliance on prepackaged content from third-party providers, coupled with a messy presentation, makes this provider's site impersonal and difficult to navigate

Provider Aetna
Members 15 million
Site aetnanavigator.com

The Bottom Line It offers by far the richest online selection of the Big Three, including a nifty set of tailored six-week health regimens that target specific goals, such as controlling high cholesterol, losing weight, and getting in shape

*Secondary plans may be accessed via separate Web addresses. **Data:** Company reports, BusinessWeek

Putting a Collar on Investment Risk

Options-based strategies can keep stock losses from getting out of line. **BY ADRIENNE CARTER**

PLENTY OF STOCK MARKET shocks have underscored the need to protect your portfolio. Consider Google's 7% drop on Feb. 1 or General Motors' bankruptcy scare, which cut the price in half in recent months. Such losses can be hard to make up, especially if you're close to retirement. "You wouldn't think of not insuring your home," says Thomas J. Schwab, a founder of the investment firm Summit Portfolio Advisors. "But no one thinks about insurance when it comes to their investments."

Schwab (no relation to Charles) considers such insurance critical. With investors stung by the bear market of just a few years ago, Schwab, then a financial adviser at Smith Barney on the Hawaiian island of Maui, figured clients needed more protection against crushing losses. Looking at a myriad of strategies, he zoomed in on an options-based trade called a "collar" that uses a combination of



puts and calls to keep losses and gain a stock within a specific range.

Schwab's collar strategy is at the core of the advisory firm, which opened in September of last year and now has \$7.5 million in assets under management. In it has turned the typical portfolio management process upside down. Instead of choosing stocks first and then protecting them with options, he chooses stocks on which he can place a low-cost collar that gives him at least twice as much potential gain as loss.

LIMITED POTENTIAL

OF COURSE, INVESTORS could always protect against price declines in a stock by buying a put option alone and keeping the potential gains. That gives them the right but not the obligation to sell a stock at a particular price. But put options will kick in near the current stock price and are generally expensive. That's why managers like Schwab sell call options—the obligation, in this case, to relinquish the stock at a particular price—to offset the cost of the puts. Done right, the total collar should cost less than \$1.00 per share (before commissions), and can even net a credit.

The beauty of a collar is that you know, from the outset, the potential losses and gains on a trade. In a steady bull market, your returns are likely to be somewhat muted because in buying a call, you've given up the right to appreciation beyond a certain price. On the flip side, you'll have the comfort of knowing you're protected if the market heads south. "We're a fan of collar for large portfolios, especially retirement accounts," says Kevin Lund, a strategist with Optionetics, a firm that gives options courses. "There is just no reason to take much risk just for a potential gain."

Take Google, which was tra

Catastrophe Insurance for Your Portfolio

With a strategy called a "collar," you buy a put option on a stock that protects your downside. You pay for that insurance by selling a call option that expires at the same time. The maneuver allows you to temper your risk, but it does limit your upside potential.

STOCK (SYMBOL)	PRICE	BUY PUT OPTION EXPIRATION/STRIKE PRICE	COST	SELL CALL OPTION EXPIRATION/STRIKE PRICE	PROCEEDS	COLLAR COST (PROFIT)	BEST GAIN	WORLD
Dell (DELL)	\$29.42	1/20/07 at \$27.50	\$1.70	1/20/07 at \$35.00	\$1.30	\$0.40	17.4%	7.1
General Electric (GE)	32.85	1/19/08 at 30.00	1.95	1/19/08 at 40.00	1.25	0.70	25.2	4.1
Google (GOOG)	378.82	1/19/08 at 370.00	63.10	1/19/08 at 470.00	64.00	(0.90)	24.4	2.1
Pfizer (PFE)	25.53	1/19/08 at 22.50	1.85	1/19/08 at 30.00	1.55	0.30	23.6	5.1
Walt Disney (DIS)	25.24	1/19/08 at 25.00	2.45	1/19/08 at 30.00	2.05	0.40	19.1	0.1

Data: Summit Portfolio Advisors LLC

ed 379 after lackluster earnings
ed the stock. Schwab recom-
ers buying a 370 put that expires in
y, 2008, which costs around
30 per share. Next, sell a 470 call
the same expiration date, collecting
4 per share. In all, that collar nets 90¢
e. If the stock closes above 470,
ain on the investment will be
over the next two years, but the
loss would be only 2.1% should the
drop below 370. "This is a stock
it could scare me to death if I owned
night," says Schwab. "With a collar,
lower the risk."

Of course, commissions count. Even
n costs have come down dramati-
recent years, trading options still
to be pricier than buying a stock.
esting a collar strategy on 100
of Google, say, would cost
5 at the discount brokerage Op-
press, vs. \$14.95 for just buying
stock. This strategy generally makes
from a cost perspective if com-
missions lower
your potential re-
turns by no more
than one percent-
age point.

Options
offset
cost
pricey
US

He sticks with
names that have
names with an expiration date one to
years out, since he prefers to be a
y-and-hold investor rather than a
ad. Potential collars can be found on
s Web site (protectyourstock.com)
nd include scores of blue-chip compa-
es like Apple Computer, General Elec-
c, and Procter & Gamble. It's the same
ye invests much of his own money.
Swab got into the investing busi-
ss by chance. As an undergrad at
ot Dame in the late '60s, Schwab
reviewed with the New York Stock
change only as a favor to a profes-
r. After spending a few years at the
change auditing brokerage firms, he
oyed to Goldman Sachs and later
n Barney as a financial and pen-
or consultant. Today investing is a
my affair, with both his daughter,
tz, and his son, Joe, running the firm
thim. "I wish I had been smart
ough to use this strategy years
go," says Schwab. Investors can be
ner today. ■

Not Your Average Science Project

A high school student's study of successful fund managers yields some surprises. **BY LAUREN YOUNG**

AS HIGH SCHOOL STUDENTS select topics for the annual Intel Science Talent Search, they typically gravitate toward math, biochemistry, and medicine. Chad Sandler chose mutual-fund managers.

Sandler, 17, a senior at North Shore Hebrew Academy High School in Great Neck, N.Y., wanted to develop a profile of an ideal fund manager. He focused on demographic data, including where fund managers lived, what schools they attended, and what academic degrees they held. His project, "The Highways and Byways of Fund Management: Selected Demographic Characteristics as Predictors of Mutual Fund Success," was a semifinalist among 120,000 submissions for the 2006 Intel competition.

Based on previous academic research, Sandler thought managers who graduated from top-tier universities and held MBAs would outperform their peers, and they did. But he also discovered some surprises. First, fund managers based in mountain time zone areas had better track records than those located in U.S. commercial centers. While a top-notch academic background is useful at the start of a career, after six years in the business, managers from second-tier universities matched the performance of tier-one graduates. "New

managers remain with the herd until they are more confident and established in their position," Sandler says.

Such findings are more useful to the average person than those of the typical Intel project. (A finalist for the 2006 Intel contest included "Foraging Behavior and Food Preferences of Argentine Ants.") "Because more people are invested in mutual funds today, including so many baby boomers, [the fund project]

has a social significance," says J. Harris Nierman, director of social sciences at North Shore Hebrew Academy and one of Sandler's advisers.

What motivates a high school student and fan of *The Simpsons* to study mutual funds? "I've always been interested in economics and investments," says Sandler, who regularly reads financial publications and watches CNBC. In ninth grade, Sandler placed seventh among New Yorkers in the Stock Market Game, a program sponsored by the major ex-



SANDLER Intel talent search semifinalist

changes that lets students manage a simulated portfolio.

For the Intel project, Sandler spent two years crunching data from 151 funds. He also combed the Morningstar fund database and reviewed research from behavioral finance economists.

Sandler may bolster his own portfolio with his \$1,000 Intel prize. If he follows his study, funds from Denver-based Janus or Salt Lake City's Wasatch Advisors are likely recipients. ■

EDITED BY MONICA GAGNIER

DEDUCTIONS

DONATIONS THAT SUIT THE TAXMAN

BEFORE YOU DONATE those used sweaters and shoes to charity, make a list for your files of the items and the approximate value of each. A recent tax court case made it clear that you need such backup to defend yourself in an audit if you've taken an income tax deduction for noncash contributions totaling \$250 or more. A standard receipt from a charity for a total dollar amount is not enough.

The case, decided on Jan. 26, involved an Arizona couple who ran afoul of the Internal Revenue Service because they couldn't document \$7,000 in noncash deductions. After disallowing most of



the deductions and an additional theft loss claim, the IRS increased their taxes by \$3,015 and slapped on a 20% penalty.

To avoid similar problems, refer to the Salvation Army Donation Guide (salvationarmysouth.org/valueguide.htm). Users of the premium versions of TaxCut and TurboTax can consult the deduction software included for free. Or, price comparable items on eBay, print the posting, and keep it with your records, advises Laura Peebles, a director at Deloitte Tax in Washington, D.C. If your annual deductions for noncash items total more than \$500, you'll need to report them separately on Form 8283.

For cash contributions of \$250 or more, you need a canceled check or a charity receipt. If you have neither—say you dig deep at church—the IRS will probably let you off the hook if you've gone by the book with your noncash donations, Peebles says.

—Deborah L. Jacobs



TASTE

Cheesed Off

SACRE BLEU! Red wine and cheese aren't such a good pair after all. So say researchers at the University of California at Davis. In a recently released study involving eight cheeses and eight red wines, trained tasters found that cheese reduces the perception of red wine's attributes, including oak flavor and acidity (an exception is buttery aroma, which is enhanced). One reason, they theorize, is that cheese coats the palate.

The findings were not greeted warmly. "I've had all kinds of people call and yell at me," sighs Hildegard Heymann, a professor of sensory science who oversaw the study. All the fuss aside, experts have long known that red wine can be tricky to pair with cheese, especially pungent varieties like blue. White wines and Champagne are more reliable matches; their sweetness and sparkle can better stand up to the fatty cheese. But some reds can work, too. Max McCalman, *artisanalcheese.com's* managing director, suggests a good farmhouse cheddar with pinot noir.

Heymann concedes that, outside the lab, taste is subjective. "Any wine you love will make a match with any food you love," she says. Now that's something to raise your glass to.

—Amy C.

TIME OFF

THE ASIA SOCIETY, the New York nonprofit founded by John D. Rockefeller III in 1956, will display 150 works of art amassed by three generations of Rockefellers. The show (Feb. 24–Sept. 3) includes paintings and sculptures from Afghanistan to Southeast Asia, ranging from an 8th century Thai bronze Buddha to a fan print by 19th century Japanese woodblock master Utagawa Hiroshige (right). Photos of the Rockefellers' New York estate, Kykuit, will be on view, too. Tickets are \$10 at AsiaSociety.org. —Bremen Leak



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BY GENE G. MARCIAL

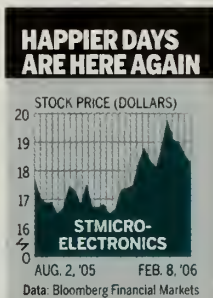
THE TECH DOLDRUMS MAY BE WANING AT **STMICROELECTRONICS**

MEDALLION IS RAKING IN INTEREST ON LOANS FOR TAXI SHIELD:

DRUGMAKERS RELY ON **ILLUMINA** PRODUCTS IN THEIR GENE R&

Is STM the Mend?

STMICROELECTRONICS (STM) may finally be on the road to recovery. Like the rest of the microchip industry, STM has had a tough ride since 2000, when the stock peaked at 73. It plunged to 11 in 2002 and has since edged up to 18. Some analysts think the price now reflects the worst that could happen. With cost-cutting in place under new management and increased use of its chips in smart phones, music players, mobile TVs, and car safety cameras, STM is geared to take off, say some bulls. The recovery is not just "a flash in the pan" argues Andrew Griffin of Merrill Lynch, which has done nonbanking business with STM. Griffin, who rates the stock a buy, reports that executives are showing the "most confidence since the tech bubble." He says they expect to see years of restructuring bear fruit in the second half of 2006. CEO Carlo Bozotti predicts global chip sales will grow 7% to 10% in 2006. Revenues in 2007 will increase at double-digit rates, he adds. Another bull, Antoine Badel of Credit Suisse (it has done banking for the company) says STM has demonstrated that margins are recovering. Meeting forecasts in the past three quarters "should contribute to restoring investor confidence," he adds. Badel estimates STM will earn 95¢ a share in 2003 and \$1.30 in 2007. He figures demand for wireless handsets will keep rising, mainly for Nokia, which accounts for 17% of STM's sales.



Medallion Financial Is Cruising Right Along

THE SMALL MEDALLIONS THAT taxicabs display to show they're licensed earn big bucks for Medallion Financial (TAXI). Prices in New York have rocketed from \$195,000 in 2001 to \$400,000—and keep climbing as demand outstrips supply, since only a few new ones are auctioned each year. As the No. 1 financier to cabbies in big cities such as Boston, Chicago, and New York, Medallion makes a tidy profit on its 7%-to-9% interest. "The Street underestimates the potential of Medallion, which serves a niche that traditional lenders overlook," says Michael Kubas of Davidson Investment Advisors, which focuses on little-known value stocks. With earnings growth in double digits

and a price-earnings ratio of 17, Medallion, whose stock trades at 12, is "compelling," says Kubas. Medallion President Andrew Murstein notes that loans rose 25% in a year, to \$434 million. Medallion, which also lends on boats and RVs, is a dividend play, as well, with a 5% yield, he adds. Robert Napoli of Piper Jaffray, who rates it "outperform," figures Medallion earned 74¢ a share in 2005. He sees 83¢ in 2006 and 92¢ in 2007.



Fast Growth at Illumina Is in the Genes

ILLUMINA (ILMN) HAS BECOME a rising star in the complex analysis of gene variation, and the stock shows. Since early January the shares have risen some 50%, to \$12. The company develops research tools for genotyping and gene expression, which provide information to improve drugs and other therapies. The tools help Big Pharma and academic labs process the billions of tests necessary to convert raw gene data into medically valuable info, not only to improve drug development but also to customize diagnoses and treatment, says Jeffrey Loo of Standard & Poor's. He sees a 60% jump in Illumina's 2006 sales, to \$118 million, up from 2005's \$73 million. Understanding genetic changes is critical to developing personalized medicine, says Loo. Illumina is one of five U.S. players in a global project to create a map of genetic variations for disease-related research. Genotyping, the fastest-growing sector of gene analysis, is where "we are winning more customers than our rivals," says Illumina CEO Jay F. Sullivan. According to John Sullivan of Leerink Swann, who rates the stock "outperform," Illumina's new product, 500K BeadChip, to be launched this year, will make the company more competitive with DNA chip technology leader Affymetrix.

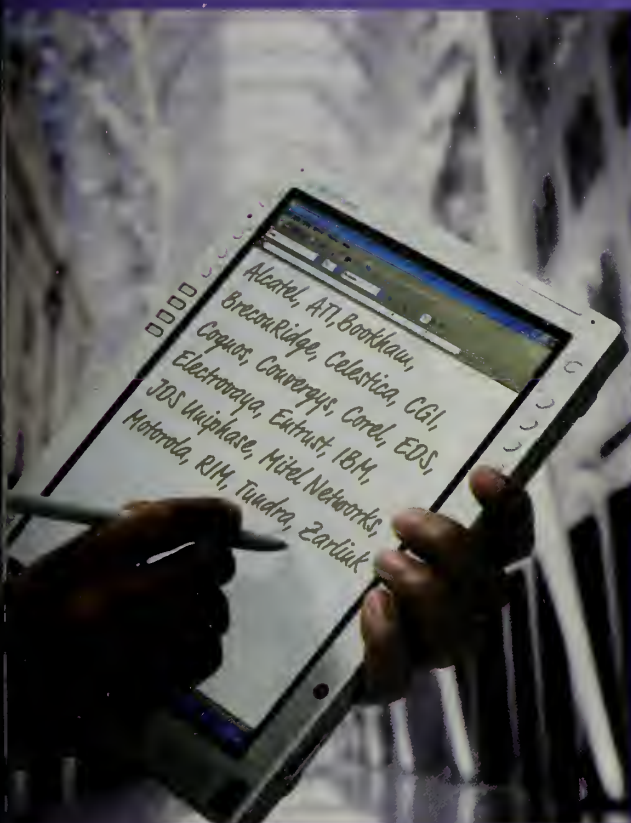


BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the author holds positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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Personal Business Figures of the Week

STOCKS



COMMENTARY

Signs of falling productivity and rising inflationary pressures, along with the Iran nuclear crisis, lopped more than 1% off the S&P 500 index in the first two trading sessions. Stocks never recovered. Rising housing inventories sent stocks lower on Feb. 7, but tech stocks jumped on Feb. 8 when Cisco posted strong earnings and forecast strong sales for the next quarter.

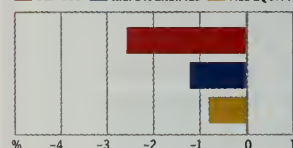
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED FEB. 7

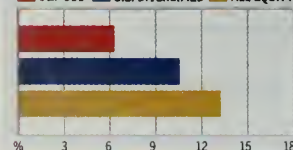
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED FEB. 7

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	FEB. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1265.7	-1.3	1.4	5.3
Dow Jones Industrials	10,858.6	-0.9	1.3	1.2
NASDAQ Composite	2267.0	-1.9	2.8	8.6
S&P MidCap 400	768.3	-1.7	4.1	16.0
S&P SmallCap 600	372.6	-2.0	6.2	12.7
DJ Wilshire 5000	12,757.2	-1.4	2.1	7.7

SECTORS

	FEB. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	754.2	-2.0	1.7	6.7
BW Info Tech 100**	384.1	-2.0	1.0	6.6
S&P/BARRA Growth	602.2	-1.4	1.0	4.3
S&P/BARRA Value	659.5	-1.2	1.8	6.3
S&P Energy	400.5	-3.8	7.4	28.5
S&P Financials	424.9	-1.0	-0.3	4.4
S&P REIT	160.8	-2.5	5.1	17.9
S&P Transportation	253.8	-1.1	1.6	15.3
S&P Utilities	160.1	-2.2	0.3	8.3
GSTI Internet	199.4	-4.0	-2.8	23.4
PSE Technology	871.5	-1.1	4.2	15.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	FEB. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1578.6	-2.2	4.4	
London (FT-SE 100)	5725.1	-1.3	1.9	
Paris (CAC 40)	4895.1	-2.1	3.8	
Frankfurt (DAX)	5666.4	-1.0	4.8	
Tokyo (NIKKEI 225)	16,272.7	-1.3	1.0	
Hong Kong (Hang Seng)	15,373.4	-2.3	3.3	
Toronto (S&P/TSX Composite)	11,735.1	-1.8	4.1	
Mexico City (IPC)	18,410.2	-3.9	3.4	

FUNDAMENTALS

	FEB. 7	WEEK AGO	YE
S&P 500 Dividend Yield	1.81%	1.77%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	17.9	18.1	2
S&P 500 P/E Ratio (Next 12 mos.)*	14.6	14.9	1
First Call Earnings Surprise*	3.20%	3.29%	4

*First Ca

TECHNICAL INDICATORS

	FEB. 7	WEEK AGO	R
S&P 500 200-day average	1223.7	1221.4	Pos
Stocks above 200-day average	63.0%	68.0%	Nu
Options: Put/call ratio	0.80	0.66	Pos
Insiders: Vickers NYSE Sell/buy ratio	4.02	3.84	Neg

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Agricultural Products	17.5	Divsfd. Metals & Mining 69.5
Steel	13.1	Oil & Gas Refining 67.8
Railroads	10.9	Oil & Gas Equipment 67.7
Constr. Materials	9.7	Oil & Gas Exploration 61.4
Constr. & Farm Mchnry.	8.5	Oil & Gas Drilling 59.1

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Internet Software	-24.2	Automobiles
Internet Retailers	-21.2	Photographic Products
Tires & Rubber	-17.4	Auto Parts & Equip.
Auto Parts & Equip.	-13.9	Building Products
Educational Services	-9.4	Divsfd. Commercial Svcs

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	4.5	Latin America	67.0
Diversified Emerg. Mkts.	3.1	Precious Metals	60.2
Precious Metals	3.0	Natural Resources	45.5
Pacific/Asia ex-Japan	2.5	Diversified Emerg. Mkts.	42.9
LAGGARDS		LAGGARDS	
Large-cap Growth	-3.0	Domestic Hybrid	6.0
Technology	-2.6	Large-cap Blend	7.1
Financial	-2.2	Large-cap Value	7.4
Health	-2.2	Miscellaneous	8.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Dreyfus Prmr. Gr. China A	12.8	ProFunds Ultra Japan Inv.	101.3
ProFunds UltSh. OTC Inv.	11.6	ProFunds Precs. Mtls. Inv.	85.6
Rydex Dyn. Vent. 100 H	11.6	ING Russia A	84.7
Gartmore China Opps. A	10.9	Midas	77.9
LAGGARDS		LAGGARDS	
ProFunds Internet Inv.	-13.1	Ameritor Investment	-63.2
Rydex Dyn. Veloc. 100 H	-10.8	American Heritage Grth.	-42.9
ProFunds UltraOTC Inv.	-10.8	Frontier MicroCap	-25.9
Alpine U.S. RI. Est. Eq. Y	-10.6	ProFds. Ush. Mid Cap Inv.	-24.9

INTEREST RATES

KEY RATES

	FEB. 8	WEEK AGO	YE
Money Market Funds	3.99%	3.94%	1
90-Day Treasury Bills	4.51	4.48	2
2-Year Treasury Notes	4.63	4.58	3
10-Year Treasury Notes	4.59	4.56	4
30-Year Treasury Bonds	4.68	4.71	4
30-Year Fixed Mortgage†	6.19	6.14	5

†BarrsQuot

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.85%	
Taxable Equivalent	5.50	
Insured Revenue Bonds	3.93	
Taxable Equivalent	5.61	

THE WEEK AHEAD

RETAIL SALES Tuesday, Feb. 14, 8:30 a.m. EST » January retail sales most likely rose 0.7% for a second straight month. That's the median forecast of economists polled by Action Economics LLC. Minus autos, sales probably grew 0.6%, after a 0.2% December gain.

BUSINESS INVENTORIES

Tuesday, Feb. 14, 10 a.m. EST » December inventory levels are expected to have risen 0.3%, after a November jump of 0.5%.

INDUSTRIAL PRODUCTION

Wednesday, Feb. 15, 9:15 a.m. EST » Factory output very likely improved 0.2% in January, after a 0.6% gain in December. The average operating rate probably edged up to 80.8%, from 80.7%.

RESIDENTIAL CONSTRUCTION

Thursday, Feb. 16, 8:30 a.m. EST » Housing starts in January most likely rebounded to an annual rate of 2 million, after slowing to a pace of 1.93 million in December.

EXPORT-IMPORT PRICES

Thursday, Feb. 16, 8:30 a.m. EST » January export prices are expected to have risen 0.1% for a second consecutive month. Import prices probably climbed 0.6%, following a 0.2% fall in December.

PRODUCER PRICE INDEX

Friday, Feb. 17, 8:30 a.m. EST » Producer prices probably held steady in January, after a 0.9% rise. Less food and energy, prices likely grew 0.3%, after a 0.1% gain.

The BusinessWeek production slipped to 269.5 for the week ended Jan. 28, but remained 12.7% above the year-ago level. Before calculation of the four-week moving average, the index eased to 269.1.

BusinessWeek

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

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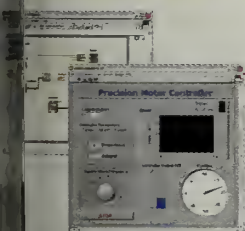
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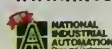


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HP's Executive VP of Global Operations Discusses Multiple Routes-to-Market on a Global Scale

In today's world, the rapid pace of change forces companies to manage new manufacturing processes, new product introductions, rapidly evolving supply chains, new customer demands and increased regulatory pressures. Added to this is the growing role that outsourcing and value-added services play in manufacturing, plus the need to reduce costs. In order to deal with these issues, companies are deploying sophisticated information technology solutions.

In our global economy a growing number of manufacturers depend on effectively managing multiple

routes-to-market (RTM) on a worldwide scale. On Wednesday March 22 at 1 PM, HP's Executive Vice President of Global Operations, Gilles Bouchard, will discuss the balancing act of managing to continually optimize RTM while simultaneously building customer loyalty and beating the competition.

In addition, HP experts present on Tuesday March 21, "Simplifying the Worlds of Business," Kevin Leighton, Director of Supply Chain Integrated Solutions, Global Operations Supply Chain

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- Thermoplastic Elastomers: Injection and Over-molding

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Clean Rooms

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ing, not just in pharmaceutical, medical device manufacturing and computer component assembly, but in all industries. With modular components, manufacturers can expand their systems as their needs expand.

The Simplex AirLock cleanroom with latch-together frames and inserts

assembles in hours. Simplex also manufactures softwalls, barriers and plant divider curtains for process isolation, temperature regulation, dust control and noise abatement.

Simplex recently introduced GatorJaw, an all-purpose aluminum framing for building clean room components, process barriers, safety enclosures, work stations and shelving systems. It is a welcome alternative to the cumbersome T-slot technology.

"You will even find Simplex at NASA," concluded President Duane McKinnon. "Simplex is the choice when performance and ease of use counts."

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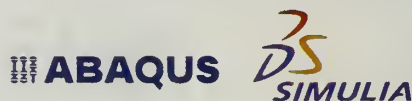
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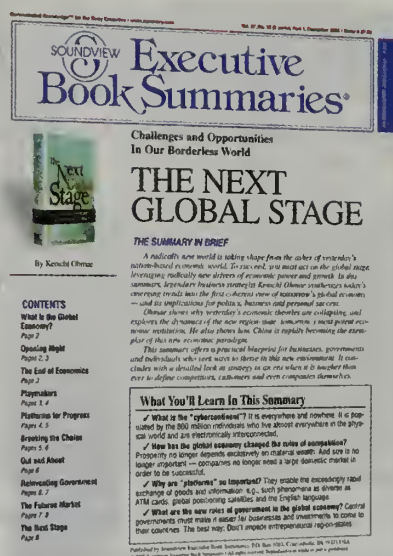
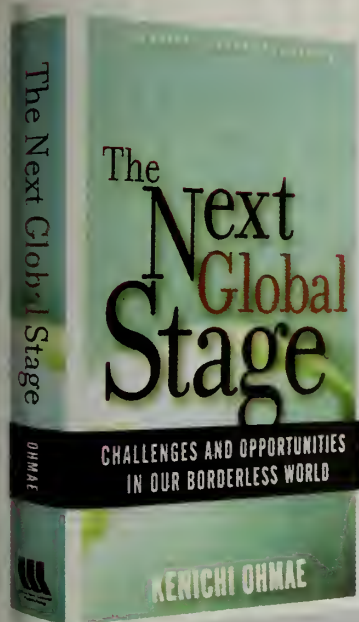
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How to Pick a Business Brain

EXECUTIVE INTELLIGENCE What All Great Leaders Have

By Justin Menkes; Collins; 306pp; \$27.95

Why is it that one newly minted executive becomes a spectacular success and another a miserable flop? For decades, hiring managers and corporate boards have exerted considerable energy trying to figure out what separates future business stars from the also-rans. Is it charisma? Emotional intelligence? Or

simply a profound knowledge of the industry in which they work?

None of the above, argues Justin Menkes. In his thoughtful *Executive Intelligence: What All Great Leaders Have*, the Los Angeles psychologist and business consultant makes a persuasive case that the real answer is superior reasoning and problem-solving skills that enable the executive to cut through the fog of conflicting data and "create a solution tailored to suit each situation at hand." The author cites Jack Welch, David Packard, and Sam Walton, among others, as leaders who thrived because they were great critical thinkers, possessing the elusive intelligence of the book's title. Menkes offers a stimulating analysis of an important topic, but brace yourself for an unsatisfying conclusion.

Far from being a dry human resources tome, *Executive Intelligence* provides a stimulating overview of how the definition of intelligence has evolved over the years. Menkes distills mounds of complex research and restates it in accessible language. He then supplements it with interviews of such successful CEOs as Avon Products Inc.'s Andrea Jung and Dell Inc.'s Kevin Rollins, who discuss their own hiring philosophies and leadership styles. One example of Jung's critical thinking: her decision, while head of product marketing, to consult with and cultivate Avon's all-important sales reps rather than simply forcing change through a top-down edict. The largely female sales force was balking at a shift to higher-priced lines of perfume, which they feared their current customers wouldn't buy. At meetings around the country, Jung asked reps just how many of them actually used Avon products themselves. Most were forced to concede they didn't and quickly came around to Jung's belief that the company's wares had become too downmarket.

Menkes believes the traditional job interview is a poor method of finding people with executive intelligence. Interviews, he says, are little more than opportunities for candidates to boast about past achievements, for which they may or may not actually deserve credit. Meantime, the

interviewer learns little about how a prospect will handle future challenges. The author also discusses the most popular supplemental interviewing methods, from personality assessments to emotional intelligence tests, and concludes that most are flawed. Interestingly, Menkes argues that although IQ tests have been condemned for racial bias, the "unquestionably powerful indicators of executive aptitude." But these, too, have their limitations, he says, as most consist of multiple-choice questions and don't deal with real-world business issues.

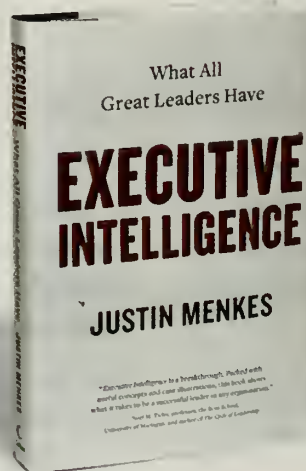
The best tests, he says, measure the ability to accomplish tasks, work with and through others, and evaluate oneself and adapt accordingly. Dissecting each of these traits, Menkes defines 17 critical skills that the best managers use to think their way through problems. Among them are the capacity to distinguish between primary and secondary goals, anticipate probable outcomes as well as unintended consequences, and recognize the underlying agendas of others. The best way to find out if prospective hires have these talents? An oral exam comprising hypothetical business problems, since most business decisions are made in such a real-time conversational setting.

Menkes provides a handful of sample questions and answers. (This offers readers the side benefit of finding out if they themselves possess executive intelligence.) One question asks whether a software outfit facing severe price competition should outsource its programming abroad. Menkes doesn't see there's a right answer. But he gives highest marks to the hypothetical candidate who questions the effect of doing so on the morale of existing workers and notes the risk of becoming dependent on foreign contractors for new-product development, maintenance, and customer service—all possible unintended consequences.

Defining the critical skills that set apart the extraordinary executive

As insightful as Menkes' book is, many readers may find themselves in the lurch. How, one may ask, can I come up with a more complete exam? Well, Menkes' consulting firm, Executive Intelligence Group, develops just such tests for corporate clients. They've got the questions and will share them for a price. That's too bad. The best books in this genre really offer you what you need to know, but here, in the end, Menkes offers up little more than an hors d'oeuvre. ■

—By Dear



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WITH MARIA BARTIROMO

Lee Raymond: Exit Interview

WHEN EXXON MOBIL on Jan. 30 reported the most mind-blowing gains ever racked up by a public company in a single year, howls of outrage were heard in Washington, and the pundits pounced. But it was just Lee Raymond's way of saying so long, and thanks for the memories. Just a month earlier, Raymond, the architect of ExxonMobil's spectacular showing, retired from his post as CEO. I caught up with Lee twice over the course of the past month or so, and this interview is distilled from those talks.

ExxonMobil reported a record fourth quarter: \$10.7 billion in earnings, \$36 billion for the year. Don't numbers like that raise the pressure for a windfall-profits tax?

I would hope not. The realization is dawning on people that a huge investment is needed for the oil demands of this country and the world, and you need a huge income stream to [make those investments]. What a lot of Americans don't understand is 75% of our profits don't even come from this country.

Still, do you worry about higher taxes?

Sure, we still worry. Frankly, all of American business should worry about that, because if Washington gets in the mode that they decide some company's profitability should be controlled...or whether it's too high or low, then they are not just going to single out industries, but companies within industries. The next thing you might see is that they think CNBC or *BusinessWeek* is making too much money.

Can we wean ourselves off Mideast oil, as President Bush suggested we should in the State of the Union Address?

Energy is the lifeblood of the world economy, and oil and gas are the dominant energy forms. That is not going to change anytime soon. We might be able to reduce our dependence to a modest degree, but in reality, so long as the economy continues

to grow, we will have to import substantial oil and import more natural gas than we do right now. Most developed tries in the world find themselves in that position. And the Mideast is where the reserves are.

Should that concern us given our relationship to the Mideast? Many people are worried about Iran.

Sure, it should concern people, and that is the point a number of us have been making for a long time.



SNAPSHOT

I CAN REMEMBER when if heating oil moved a quarter of a cent... that was a big deal. It would go from 8¢ to 8¼¢ a barrel. One time we sat and argued as the crude-oil market was starting to strengthen. We had some Iranian heavy crude that someone wanted to buy. We debated all day on whether to charge them \$1.25 or \$1.26 a barrel. After all that, we charged them \$1.25 and a half-cent.

Do you think we went to war over oil?

No, not in that sense. It's always difficult to synthesize why we went into Iraq. I do think there was concern people had regarding the stability in the region.

Are we going to have to send troops to protect oil fields around the world? As China and India continue to grow, we need more oil, what happens to us?

The major economies in the world are competing for the world's pool of oil supplies. We really don't have any spare capacity, but we have to recognize we're part of the pool. We are not isolated and don't isolate ourselves. History suggests supplies will begin to grow faster than they have been. The IEA [International Energy Agency] has said that by the end of the decade there will be significant spare capacity again. People don't understand the time dimension in our industry: It doesn't happen overnight.

So prices should go down?

Yes, that would mean lower prices.

had that view for the last couple of years...that the current price level cannot be supported.

Should China be allowed to acquire a U.S. oil company?

I think there was much ado about nothing with regard to the Unocal-CNOOC deal. Unocal was really not a big deal in this industry.

So China should be able to buy ExxonMobil?

[Laughs] Well, Maria... they are going to have a hard time buying my shares. ■

Maria Bartiromo is the host of CNBC's Closing Bell.

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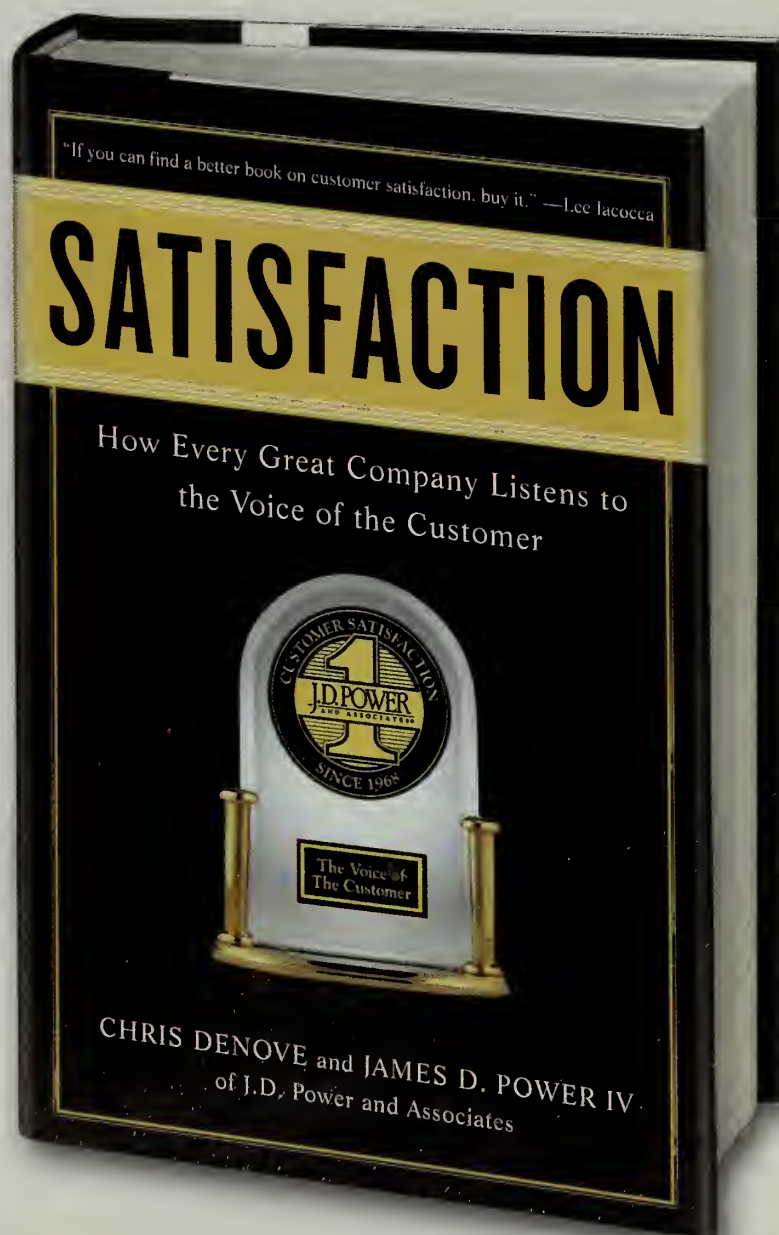
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Recognizing the Entitlement Peril

GIVEN THE BUSH Administration's flagging ratings and its reluctance to make waves in an election year for the GOP-controlled Congress, most Washington observers figured that little of substance will be done this year to address the spending growth in federal benefit programs.

Thankfully, they were only half right. It appears the White House is at least keeping alive the possibility that it might begin to address entitlement reform this year.

To be sure, the Administration's most high-profile move, the bipartisan commission on entitlement spending unveiled during the President's State of the Union message, is actually the least important event here. With a few notable exceptions such as the 9/11 Commission, such bodies have long been Washington's way of handing off issues that the pols consider too hot to address politically. The entitlement study will undoubtedly tell us that the current course of spending for the big three programs—Social Security, Medicare, and Medicaid—is unsustainable. Disturbing and true, but we've long known that.

Instead, two relatively unheralded provisions in the President's Feb. 6 budget proposal to Congress suggest that the Administration is ready to test reactions to any tweaking of the politically contentious programs. First, Bush proposed cutting reimbursements to health-care providers in the Medicare program by about \$26 billion. Although that and other proposed cuts would slow Medicare growth only by \$36 billion over five years (overall costs will still rise sharply), it's a significant move nonetheless in an election year.

This wouldn't be the first time Washington has battled over how much to pay doctors, hospitals, and other Medicare providers. In the 2006 budget, which Congress finally approved last week, payments to doctors were a major sticking point. The law first called for cutting their compensation by 4.4%. By the time the dust cleared, however, the payments were only frozen. So if Bush is serious about getting savings from providers this year, he must be prepared to battle some of the nation's most powerful lobbies.

Also in its budget, the White House proposed higher Medicare premiums for the affluent. Plenty of precedents exist in our progressive tax system for those who make more to pay more, so this isn't revolutionary. But it could strike a nerve with voters long wary of applying means tests to recipients of entitlements. More important, it's a recognition that the Administration hasn't forgotten that Medicare, whose

costs are soaring because of health-care inflation and net drug benefits, is actually more of a present danger to the nation's long-term fiscal health than Social Security.

Indeed, if we do nothing, the big three programs are forecast to eat up nearly 20% of America's gross domestic product by 2040, roughly the share consumed by all federal spending today. In other words, without entitlement reform or huge tax increases, we would basically just be able to pay the big three after shutting down the rest of Washington (including the Pentagon). Obviously, that's not going to happen, so it's time for Washington to get serious about putting the brakes on these out-of-control entitlements before they cause the economy to crash and burn. The President's budget proposal, while not nearly enough, is a much-needed start. Congress should follow his lead.

Don't Discount Diesel

FOR MANY AMERICANS, diesel-powered cars are just another bad memory of the 1980s, like Milli Vanilli, fingerless gloves, and Mohawk hairstyles. Those diesels of yore were noisy, soot-belching vehicles that could barely outrun a Yugo out of the starting gate. But advances in technology have made diesel all the rage in Europe, where they'll account for more than half of all passenger cars sold this year. And automakers such as DaimlerChrysler and Volkswagen hope to repeat that success in the U.S. after new federal rules requiring gas stations to carry cleaner-burning diesel fuel in this fall (page 49).

There's more at stake here than just some carmakers' profit from a hot auto trend. The real attraction is the prospect of reducing America's use of transportation fuels, much of which is imported. For example, Margo Oge, head of the Environmental Protection Agency's Office of Transportation & Air Quality, says the U.S. could save up to 1.4 million barrels of oil per day—roughly the amount it imports from Saudi Arabia—if a third of U.S. vehicles ran on diesel.

Domestic carmakers aren't so sure about such aggressive forecasts, noting that up to half of the fuel-efficiency advantage regular diesel engines enjoy over gasoline models could be erased by all the expensive gear and special catalytic converters needed to filter soot and scrub pollutants from diesel exhaust to meet U.S. emission requirements for cars. So it'll still be an uphill battle to revive diesel here, although clean diesel technologies such as the one unveiled recently by DaimlerChrysler should ease such concerns. But while the much-hyped clean diesel is unlikely to prove a silver bullet in solving the energy problem, the U.S. should certainly fund and investigate this—or any—promising technology that could help it regain energy independence.



BusinessWeek

2006

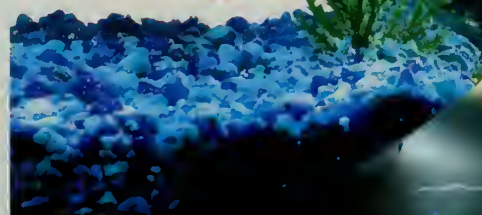
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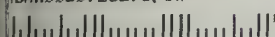
Going Private

Hotshot executives are fleeing the scrutiny of public companies for the mad money of the private-equity boom

BY EMILY THORNTON (P. 52)



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FOLLOW THE MONEY

With so much private-equity cash sloshing around, no wonder top talent is kissing off public companies



Cover Story

52 Going Private

Money and freedom. That's what's driving hotshot managers, midcareer folk and newly minted MBAs alike to private equity, a world where investors buy slumping companies, turn them around, then sell or take them public. Pay is high even at the entry level—and can be spectacular for stars like ex-IBM chief Lou Gerstner. As for freedom, CEOs can build for the long term without shareholders second-guessing every move. Not to mention the pesky Sarbanes-Oxley...

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Your own kind of music, online



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It's about money.
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Investing it.
Spending it.



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Overlooked deductions:

Tips to help lower your tax bill and boost your refund.

Teaching tunes: Kids review software that teaches them how to compose and play music.

Destination CEO: Meet Barbie's maker. Mattel CEO Bob Eckert talks about his rise to the corner office.

Barking for bucks:

Dog-related products and services are making big bucks for business owners.

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Keeping it All in the Family

As baby boomers gray, hundreds of thousands of family-owned businesses are facing a major decision: What will they do with the business? Options abound: selling to investors, giving the business to children, bringing in outside management. In this **Online Special Report**, we take a look at what families need to consider as they decide whether and how to **pass their businesses on**. Meet Chicago's Berghoff Family, who after three generations has decided to close the 108 year-old restaurant that bears their name. Visit with the 14th generation of Zildjians to find out how they've managed to keep the family's cymbal business running for nearly 400 years. Our report also examines the generation ready to take control and offers a **gallery of family-owned businesses** that have stood the test of time. You'll find this and more at www.businessweek.com/go/familybusiness



Execs Craigie and Debbie Zild of the cymbal maker marching c

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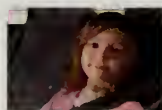


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The Power of Dreams

JP Front

"I am stunned that he would be out speechifying the first week he was off the job."

—Donald Straszheim of Straszheim Global Advisors on Alan Greenspan possibly upstaging successor Ben Bernanke with his public appearances and planned memoir, to USA Today

BY DAN BEUCKE

OTHER INDIA THE ALL CENTER URNS

IT SEEMS like you
half your life on the
with a call center in
But in India itself, call
actually are seeping
everyday life, appearing
ave of popular sitcoms
books. *India Calling*, a
Indian TV show (below)

romance, politics, hatred, all
creating high drama," says
Shristi Behl Arya, who is the
show's producer.

Indeed, the customer
service scene in India is any-
thing but boring. Centers can
be a hotbed of hormones;
some average a marriage a
month, often outside tradi-
tional bounds of caste and
economic status. *The Call
Center*, a show coming soon to
channel NDTV, takes potshots
at Americans venting their
angst about losing jobs to the

Indians on the
other end of
the wire. A
best-selling
book, *One
Night @ The
Call Center*,
touches on
love, bad boss-
es, even God

(appearing, naturally, in a
phone call). Then there are
the jokes making the rounds:
When a man complains to a
doctor about insomnia, the
doctor suggests working at a
call center as the remedy.

—Nandini Lakshman



HAPPIER DAYS
Eisner and Jobs
after *A Bug's
Life* premiere

SHOW BIZ

Eisner: Let's Break a Deal

MICHAEL EISNER now knows they can put your name on the building, but that doesn't guarantee a warm welcome back. Eisner, who left **Walt Disney** as CEO on Sept. 30, was honored on Jan. 23 when Disney named its Burbank headquarters building after him. But later that day, the board turned down Eisner's last pitch: a plea to pull out of talks to buy Steve Jobs' **Pixar Animation Studios**. For nearly a half-hour, Eisner argued that \$7.4 billion was too much to pay for a studio that had only six films to its credit, albeit blockbusters such as *Finding Nemo* and *Toy Story*. Eisner argued that Pixar's streak was bound to end and, when it did, Disney would look like it acted rashly.

Those with knowledge of the talks, first reported by the *New York Post*, say the board felt it owed it to Eisner to listen. After all, he still holds 1.7% of Disney's stock. But directors factored in Eisner's feud with Jobs, who last year said he would walk away from Disney deals if Eisner stayed. Eisner also may have lost sway after deciding in October to quit the board a year earlier than anticipated, say Disney insiders. His contract allowed him to serve as a creative consultant to the company, they say, but he chose to pursue other opportunities. Eisner has said he backs his successor, Robert Iger, who put the Pixar deal together. Disney had no comment.

—Ronald Grover

BIG PICTURE

HIT'S IN A NAME There's a new breed of Web
companies, and good luck figuring out what
they do from their names. Try to **match the
company with its description**:

- a** Multiclient instant messaging application
- b** Advertising tools for blogs and RSS feeds
- c** Online file sharing
- d** Social bookmarking and annotation tool
- e** Person-to-person e-commerce of handmade items

Answers: 1-d, 2-e, 3-a, 4-b, 5-c

DRUG WATCH

AMGEN'S BICYCLE RACE: CHEEKY?

ON FEB. 19 SOME of the biggest names in cycling will line up for the inaugural Tour of California. The race, which covers 600 miles in eight days, is billed as cycling's



biggest event this side of the Atlantic. Yet much of the buzz surrounding the race hasn't been about its elite field or scenic course but its title sponsor, **Amgen**. The Thousand Oaks (Calif.) company's red cell-boosting

drugs Aranesp and Epogen (commonly known as Epo) were developed to help cancer and kidney patients—but they also happen to be among the banned performance-enhancing drugs used by athletes.

Amgen has backed charity cycling events, but this is its first pro race. When the company announced its three-year sponsorship of the tour, cyclists snickered and the **World Anti-Doping Agency** voiced concern that Amgen was sending a mixed message. "We realized there would be critics," says Mary Klem, a company spokeswoman. Nevertheless, she says, Amgen put its name on the event to build recognition and campaign against blood doping, not to promote Epo to athletes who purchase it on the black market. "That market is inconsequential," says Klem. "It would be in our best interest for it to go away." —Sarah Max

SCHOOL TIES

TODAY'S CEOs are less likely than predecessors to be company loyalists or military veterans, says the latest census by recruitment outfit Spencer Stuart. They're also more apt to know the words to *If You Want to Be a Badger*. In 2005, 14 of the CEOs at S&P 500 companies held undergraduate degrees from the University of Wisconsin. T puts it in a tie with Harvard for first place, ahead of Princeton, Stanford, Yale, and the University of Texas. Top Badgers include Halliburton's David Lesar (zoology), Kimberly Clark's Thomas Falk (accounting), Exelon's John Rowe (history), and Qwest's Richard Notebaert (political science). —Michael A



BLOGSPOTTING

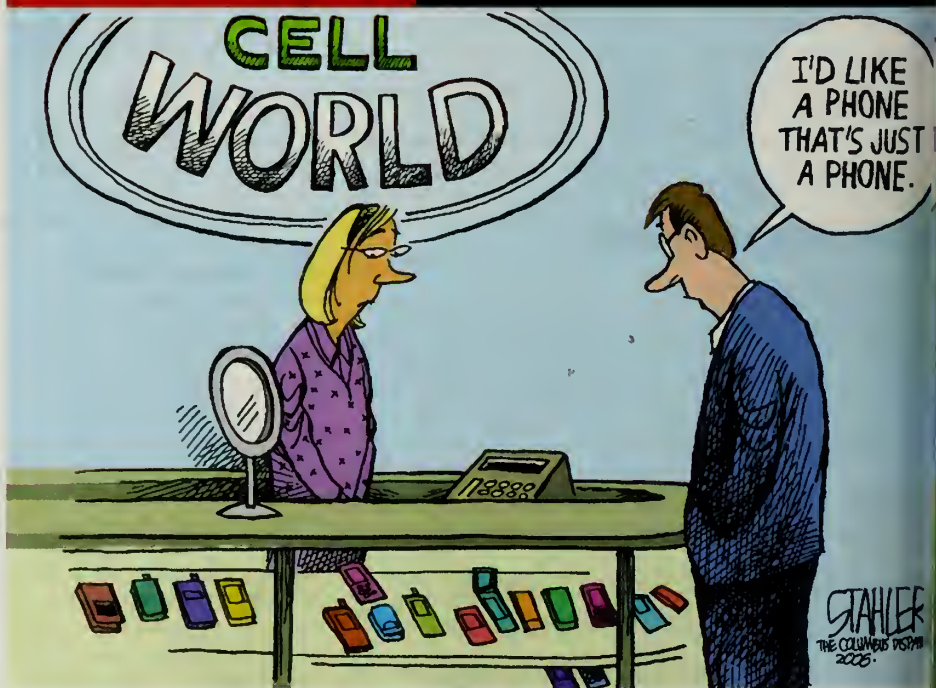
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EXPERT ADVICE

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Wine enthusiasts no longer have any excuse for buying a bad bottle. With the launch of Robert Parker Mobile, they can consult the wine critic's renowned "million-dollar nose" anytime, anywhere, by cell phone. The service, developed by mobile publisher mFoundry, will deliver Parker's wine-tasting notes and ratings from *The Wine Advocate* to any Sprint Nextel phone (other carriers are being added) for \$4.99 per month, plus Internet charges.

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Parker says he expects people to use the service mostly in wine shops. But, he jokes, "I'm sure we're going to hear some howls from sommeliers at fine restaurants." —Elizabeth Woyke

BOARD BRAWLS

A SIZZLING FAMILY FOOD FIGHT

QUINTESSENTIAL California drive-in chain In-N-Out Burger has built a cult-like following among fast-food gourmands for its juicy grilled patties and "secret" menu items. But the beef these days at the family-owned, 200-plus restaurant outfit isn't its trademark Double-Doubles but allegations that the chain's 23-year-old heir, Lynsi Martinez, and others are plotting to force out her 86-year old grandmother, the wife of the founder. It's a soap opera that includes allegations of fraud and a backroom power play. Matriarch Ester Snyder is alleged in court documents

to have told ex-employee Richard Boyd that they "only want me dead."

The saga is playing out in a state court in Los Angeles where Boyd, a former In-N-Out real estate vice-president and board member, claims Martinez and her stepsister's husband, Vice-President Mark Taylor, maneuvered to oust Boyd and take over the chain. Under the guidelines of a trust set up when Martinez' father, H. Guy Snyder, died in 1999, she would gain control of the company on her 30th birthday. Boyd, one of two

trustees, claims Martinez wants control now.

Now Boyd is fighting from the outside: On Jan. 31 the company fired him, claiming an outside audit discovered he had used company funds to do work at his Arizona home. Boyd's lawyer, Phil Heller, disputes the audit, says Boyd was fired in a meeting not attended by Snyder, who had said in a declaration weeks earlier she trusted him "completely." In-N-Out general counsel Arnold Wensinger calls Boyd's claim "a vicious and baseless attack." Martinez says Boyd circulates "outrageous fabrications and untruths about me and my grandma" in a "desperate effort to draw attention away from his own misdeeds."

—Ronald Gr



"Pedal Powered Office" (above, by artist Beate Engle) really that far off? Here are some of the other proposals.

PRESIDENT BUSH MAY BE overlooking a potent source of alternative energy. Last year artist Laurie Palmer called for "speculative proposals to redesign exercise equipment to generate and store energy." The resulting ideas, on display at the University of Illinois' Web site*, are mostly whimsical. But as energy costs rise, is it really that far off? —Megan Tu

PROJECT	DESCRIPTION
SPIN CYCLE By Clay Ward and Heather Clark	Bring your toughest suds to this 24-hour gym-powered Laundromat. Bikes rigged to washing machines require fierce footwork to power your clothes through a permanent press cycle.
HUMAN POWER CONVERSION By Raj Pandian	Pandian, a Tulane University professor, is serious about this protocol. In time, child's play could be converted into power for a school's lights and fans in developing nations.
HARVARD SCIENCE CENTER GYM By Oliver Knill	Even the biggest brains can't ditch P.E. when the gym comes to Science Center. Faculty and students stepping up a steep spiral staircase supply the power for the relaxing elevator ride back do

*www.uic.edu/aa/college/gallery400/notions/

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Re the Disney-Pixar deal: Jobs may now have a Magic Kingdom, but [Apple's] customer service is Mickey Mouse."

—Paul Baudisch
Wellesley, Mass.



HEY, STEVE, STICK WITH THE TURTLENECK BUT DROP THE CAPE

IT'S CLEAR THE ARTIST of your cover cartoon of Jobs did not see *The Incredibles* ("Steve Jobs' Magic Kingdom," Cover Story, Feb. 6). "Super" Steve is shown with a cape, and even 6-year-olds who saw the flick know that when it comes to superhero costumes, "no capes" is the rule.

—Marc Pfeiffer
Bedminster, N.J.

RE THE DISNEY-PIXAR deal: Jobs may now have a Magic Kingdom, but his customer service is Mickey Mouse. As the father in a household of two Apple iBooks and three iPods, I'm on the receiving end of Apple Computer's indifference. Owners of sick products are supposed to take them into the nearest Apple store, where they wait for hours to see a technician at the Genius Bar, even if they have purchased a ProCare card entitling them to make a service appointment.

And if they ever have a problem with a transaction at Apple's iTunes Music Store, well, they should just forget it. When I didn't receive the iTunes Gift Certificate I ordered for my son, Apple made it impossible for me to reach anybody by

telephone, and my e-mails were met with useless automated responses.

—Paul Baudisch
Wellesley, Mass.

GENERATION DEBT'S LEGIT GRIPE—OR SELF-INDULGENT WHINING

AUTHORS TAMARA Draut of *Strapped* and Anya Kamenetz of *Generation Debt* bemoan the prospects facing students who are leaving college to face a difficult world ("Up against it at 25," Books, Feb. 6). Their challenges are almost microscopic compared with the situation generation faced: We survived the Great Depression, won World War II, rebuffed Germany and Japan, built schools, colleges, universities, suburbia, and infrastructure on a grand scale. On top of all we prospered individually.

The parents of the new generation continued along the same path. With ingenuity and common sense the new generation will prosper likewise.

—Newell D. Sarant
Retired NASA engineer
Olmsted Township, Conn.

I HAVE BEEN WAITING to hear about the growing rift between boomers and Gen

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ReadersReport

ation Y. The Greatest Generation was followed by the worst. The boomer generation has put the country in massive debt, moved millions of good-paying jobs overseas, reduced future private and public retirement for the younger generations, allowed money to consume our democracy, and even started a war and passed on the tab. It's time the younger generations wake up and take action before it is too late, for themselves and for America.

—James Brown
Yardley, Pa.

OH, PLEASE! Give us boomers a break. The only place boomers have failed the X, Y, and Z generations is in failing to instill in them a sense of personal responsibility. The "expectations of material comfort" that may not be met for young people derive from pampered and coddled kids who have grown up thinking they are entitled to live a lifestyle immediately, well...because they want to!

Where is the government when a slacker needs it?

—G. Keenan
Albuquerque

AT AGE 35 I SIT firmly in Generation X. I went to college when I was 19 and lasted one semester. I returned 10 years later and finished my bachelor's degree, walking away with about \$10,000 in loans. I recently married, and my wife and I paid for our own wedding. I am about to pay off all my extraneous debt aside from school loans. I do not for one second buy into the lament that I have gotten a bum deal from my parents or anybody else. I do not believe that I am entitled to anything that I do not earn for myself and my family. If you don't have the skills, learn them. If you don't have the money, take a hard look at at your spending and stop buying that \$5 cup of coffee.

—Glenn W. Meeks
Old Bridge, N.J.

I AM AMAZED the author of "Thirty & Broke" (Special Report, Nov. 14) could maintain any sympathy, or a serious expression, as the crybaby tales of these self-indulged subjects unfolded. It might be time for those people capable of balancing a checkbook to circle the wagons.

—J. Cobb
Phenix City, Ala.

IN CHINA, SOME ARE RICH, BUT MANY MORE ARE POOR

"TO GET RICH IS glorious" (Global Business, Feb. 6), on the superrich in China, masks the disparities between rich and

poor and coastal cities vs. those inland. China is still 80% agricultural and rural. Your article focused on the prosperity of the major cities and ignored the underlying poverty. Before Mao, the same disparity existed and gave rise to the communist revolution. Now the disparity is even more noticeable because of news coverage. In Beijing and other cities, one side of the street has new skyscrapers while on the other side there are slums housing people trying to eke out a living. This can only lead to another revolution unless the living standards of the poor are brought up.

—John Ngai
Rego Park, N.Y.

EXECUTIVE CRIME STILL GOES LARGELY UNPUNISHED

PUNISHMENT OF corporate criminals may be harsher today than in the '80s, but the continuing spate of executive misdoing means the sentences handed out are not tough enough ("White-collar crime: Who does time?" Enron Special Report, Feb. 6). Senior executives continue to look for loopholes to fatten their already bulging wallets. Grants of millions of stock options are being replaced with grants of millions of shares of restricted stock.

Compliant and conniving boards of directors still shower favors on their senior executives ("Not your ordinary gold watch," News: Analysis & Commentary, Feb. 6). There's little difference between the criminal wrongdoing of a Bernie Ebbers and the excess compensation of a Hank McKinnell of Pfizer, other than the latter gets away with it because of loopholes. The laws need to be tightened to remove these loopholes.

—Chandran Cheriyan
Saratoga, Calif.

AFTER HURRICANE WILMA, WAL-MART TO THE RESCUE

RE "A SOCIAL STRATEGIST for Wal-Mart" (Up Front, Feb. 6): While Wal-Mart Stores Inc. has been under fierce attack for its alleged lack of social, environmental, etc., responsibilities, and I have been one of those critics, I would like to relate an incident that reflects credit on this embattled company.

My family and I recently survived Hurricane Wilma, along with dozens of other Americans, in a church shelter in Cancun, Mexico. When the three-day-long hurricane finally left the Yucatan Peninsula, all surrounding pharmacies and supermarkets had been looted, destroyed, or severely damaged except for Wal-Mart.

Although commercial power was still down, Wal-Mart opened its doors imme-

CORRECTIONS & CLARIFICATIONS

In "Is STM on the mend?" (Inside Wall Street, Feb. 20), Antoine Badel of Credit Suisse estimates that STMicroelectronics will earn 95¢ per share in 2006, not 2003.

diately. While all banking, ATM, and credit-card facilities were out of service over Cancun, Wal-Mart miraculously (and fortunately for those of us who were running out of cash) was allowing customers to charge their purchases to credit card.

—Maj. Dorian de Wind, USAF-F
Austin, Tex.

SAFE SUPPLEMENTS: WHAT TO LOOK FOR ON THE LABEL

"HOW SAFE ARE diet supplements" (Science & Technology, Jan. 30) neglected to note the NSF/ANSI Standard 173: Dietary Supplements, developed by NSF International in accordance with the American National Standards Institute (ANSI) and the Standards Council of Canada.

The NSF mark means the supplement has met American National Standards requirements. It also means products tested and production facilities are expected to ensure that what's on the label matches what's in the supplement.

—Kathleen Jort
Dietary Supplements Certification
NSF International
Ann Arbor, Mich.

Editor's note: Three organizations set standards and offer certifications for dietary supplements that meet the standards: the U.S. Pharmacopeia Convention (USP), the National Nutrition Foods Assn. (NNFA), and NSF International, in addition to ConsumerLab.com LLC, a for-profit company.

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Technology&You

BY STEPHEN H. WILDSTROM

Aiming for a Pest-Free PC

Keeping a home computer safe from the swarms of pests that infect the Internet has become a major chore for many consumers. You need software to protect you from viruses, spyware, spam, phishing frauds, and assorted electronic assaults—and you need to keep the programs up-to-date to stay ahead of the evildoers. Now the good guys are riding to the rescue.

In the past couple of years security software vendors such as Symantec, McAfee, and Zone Labs have helped a bit by bundling their products into security suites that provide antivirus, antispyware, and antispam software, a firewall, and parental controls for the Web. But the components don't act like a single program. And the software keeps peppering users with incomprehensible challenges such as "Windows Generic Host Server wants to access the Internet. Allow/Block."

Security vendors are working to make safe computing easier. A startup called TrustELI has a novel offering that manages your security on the router that connects your home network to the Internet, not on the PCs themselves. You buy the wireless router for \$200, subscribe to a \$10-a-month service, and follow some simple steps to configure the network. TrustELI then takes over management, including the installation of software updates on the router.

THE ADVANTAGE OF THIS APPROACH is that it is completely invisible to the user, but it has some drawbacks. Because the security is on the network rather than individual PCs, a laptop could pick up a worm if it is used on another network, say, at school, then infect other machines from inside when reconnected to the home network. Running the built-in Windows XP firewall on each PC provides a measure of protection, but some "malware" can get around it. More troublesome, the TrustELI approach requires that any Web content filtering apply to all computers on the network; if you don't want the kids to see the online Victoria's Secret catalog, you don't get to either. TrustELI says it plans to add user-specific filtering in an update.

Net service providers are also moving to make computer security management a bit easier for their customers. Earthlink provides subscribers with the Protection Control Center (available to nonsubscribers for \$5 a month), while America Online offers the Safety and Security Center. Both provide a single screen that lets you manage all the security applications and helps make sure that computers are properly



Vendors such as TrustELI are trying to make security easier to manage

set up for automatic updates, a vital step. But behind the pretty faces lie the same old programs. AOL, for example, repackages programs from McAfee. And one of the first things it does when you install it is try to sell an

"upgraded" firewall for \$3.95 a month. Security vendors are moving toward deeper integration and, with luck, smarter software that needs less user intervention. This summer, Symantec plans to release a new integrated

security application and service. Code-named Genesis, it is designed, among other things, to monitor your system to ensure that your security configuration is correct.

The wild card in the consumer security field is Microsoft. The company has announced that its antispyware product, which has been renamed Windows Defender, will be built into the Vista version of Windows due this fall. But in June, Microsoft

also will offer an integrated security service called OneCare for Windows XP and, later, for Vista. If nothing else, Microsoft's entry will shake up pricing in the industry. It will charge \$49.95 a year for use on up to three computers in a home, about what Symantec charges for a single PC.

Steps to make security software simpler and to integrate more effectively are welcome, but the industry has to improve its products so that the nontechnical consumer won't be required to make highly technical decisions. Otherwise, the bad guys will likely stay ahead in the race. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

It's So Hard To Relate

Let's begin by admitting that grown-ups have always been terrified by teenagers—their noise and warp-drive energy, their hyperactive libidos. There are fingerprints all over cultural history. Think of movies, from *The Warriors* to *Blackboard Jungle*. Think of the uproar over flappers in the '20s. Think of *Romeo and Juliet*. ¶ This fear easily transposes to media realms.

Yesterday's version was that *Grand Theft Auto* and rap lyrics would turn teens into violent, sex-crazed thugs. The newish, slightly-higher-brow version is this: Teens are too good at absorbing new technologies, too skilled in processing multidimensional streams of information. Their brains are getting too big. Soon, they'll be too far ahead of us overwhelmed grown-ups. (This, presumably, is progress.)

But if you work in media and seek realistic grounds for your next panic attack, consider this. Today's teens are the first for whom self-created content competes with teen-aimed media like videogames. There are now widespread means with which they can create and share their stuff, be it blogs, or the music recording software and design tools found on many computers, or sites like myspace.com. Established media has to grapple with the novel fact that its next generation of consumers is also competition.

"The generation under 25 is the first to grow up watching its entire life on video," says Aaron Cohen, CEO of Bolt Media. Bolt runs teen and twentysomething site bolt.com, on which self-created video documenting, say, tongue-piercings, is a major draw. (This generation also grew up with "mash-ups," in which parts of different songs are digitally reconstituted into new ones, and thus expects content to be played with as much as absorbed.) "As you grow up watching your life, you want to be [seen]," says Cohen. Not everyone wants an *American Idol*-size audience, so that show hasn't collapsed from the weight of millions of auditioners. "But everyone does want an audience," he says. Keeping it small is easy: Users can ensure that their videos posted on bolt.com are viewed only by their closest online buddies.

Hints of today's trends surfaced in past eras. A 'zine revolution of self-published periodicals exploded in the 1980s and '90s, particularly among the younger set. In that era, the plugged-in could create an alternate mediasphere from these 'zines and, say, small-label punk-inflected bands. But finding what you needed to build your own media life took tenacity. You had to know people who knew people. You had to dig



Your teen consumers have now become your competition

[social networking site] myyearbook.com," says one 17-year-old. "It's much more fun than watching TV. You can do a lot more." This teen is David Cook, and he's kind of biased because one year ago he, his younger sister, and older brother started myyearbook.com. Cook, who lives outside Princeton, N.J., makes frequent fervent declarations about how badly he wants to defeat MySpace. He hasn't yet. But myyearbook.com, which launched last May, attracted 2.3 million unique visitors last month, up from 1.7 million in November. Not only can teens now compete when it comes to making content, they can compete for the business as well. Man, Grown-ups should be terrified. ■

through stacks of records. You had to know when you could hear underground bands on which college radio station. Creating, and sharing, mediaspheres is easier now. Sarah Chubb, president of Condé Nast Publications' CondéNet-like social network sites to teens' fervently decorated rooms and notebooks, and said "in the olden days, [friends] saw the room or the notebook. Now they can see it, comment, and change it."

This is why executives at places like Condé Nast, which publishes *Teen* and *Vogue*, spend a lot of time thinking about new ways to reach teens. CondéNet is ready to launch a teen site, on which Chubb is mum. America Online, as previously reported here, will launch a suite of tools and services to enable a MySpace-ization of its wildly popular AOL Instant Messenger service.

These efforts are worth watching, but they're no slam dunk for teens whose allegiance to established media brands is tenuous. "I'd much rather use

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JAMES C. COOPER

What's Complicating Bernanke's Balancing Act

Getting the right level for interest rates is trickier in a more global economy

U.S. ECONOMY Ben Bernanke just passed his first test as Federal Reserve Board chairman. On Feb. 15-16, he held his own during a Capitol Hill grilling by both houses of Congress. But that challenge pales in comparison with those that await him. The toughest will be shaping monetary policy in a global economy. Globalization makes it

harder than ever to find the right level of interest rates to stimulate solid economic growth while keeping inflation at bay. That complication increases the chances the Fed will make a policy mistake by pushing rates too high or too low. Correcting the error could cost the economy dearly later on.

Globalization and its impact on monetary policy is not just about how worldwide competition suppresses prices of U.S. products. More and more, prices of everything from steel to corporate bonds to even labor are determined by market forces overseas, not just those in the U.S. Bernanke stressed the importance of flexibility in monetary decisions, saying that policymakers must keep "an open mind about the many factors, including myriad global influences, at play" in the economy.

Against this global backdrop, measures of labor market tightness or constraints on output capacity traditionally used by the Fed to gauge wage and price pressures have become increasingly less reliable. That is, in a global economy, the inflation potential of, say, January's 4.7% unemployment rate or last month's nearly 81% utilization rate for output capacity is much harder to interpret.

Moreover, an increasingly pervasive international market complicates the Fed's search for a neutral interest rate that neither stimulates nor restricts economic growth. Some economists even argue that, because of a lack of investment opportunities outside the U.S., the neutral rate might even be lower than the current policy stance. Bernanke himself has explored this argument, but that interpretation would imply that the Fed may have overtightened.

Right now, that seems unlikely. If anything, strong economic data for January, especially the powerful 2.3% increase in retail sales and a hefty 0.7% gain in manufacturing output, imply that rates may be too low.

EXPANDING SCOPE OF GLOBALIZATION is evident in the government's December report on international trade. The full-year tally for the volume of U.S. trade—both exports and imports—was the sum of foreign-made goods and services valued at \$3.3 trillion in the U.S. and American-made products valued at \$3.3 trillion overseas—stood at \$3.3 trillion for all of 2005. The volume has doubled in only 10 years.

Heading into 2006, trade volume accelerated. Both exports and imports posted strong advances in December—2.1% and 1.9%, respectively—and the growth rates of both sped up in the final three months of the year. During the past two years, the sum of U.S. exports and imports grew at an annual rate of 13.2%, the fastest two-year increase since 1988, when the dollar's plunge fueled

an explosion of exports. Given the resilience of U.S. demand, the continued strength in China and emerging Asia, and the gathering momentum in Japan and the euro zone, trade volumes will swell further this year.

Clearly, one alarming symbol of the new globalization is the growing imbalance in

world trade, illustrated by the ever-widening U.S. trade deficit. The gap for goods and services hit a record \$725.8 billion in 2005, based on preliminary data. The gap has ballooned to 5.8% of GDP in only the past eight years.

THAT DRAMATIC WIDENING illustrates how economies are becoming increasingly dependent on one another for rising living standards. For example, China looks to foreign markets, especially in the U.S., to generate funds to develop its economy. Cheap imports boost the purchasing power of U.S. consumers, and emerging Asian nations benefit as China outsources some of its production of materials and parts. Most important, the U.S. and other nations get China's surplus savings to help finance their investment and growth.

One result is that the Fed has less control over the cost of capital, its primary tool in keeping the economy running smoothly. With the world outside the U.S. awash in excess savings looking for a place to be invested, heavy global demand for U.S. securities is at least one of the factors holding down long-term interest rates.

More broadly, overall financial conditions are no

THE FED SEES A STRONG AND STEADY ECONOMY

FED'S CENTRAL TENDENCY FORECAST (4Q TO 4Q PERCENT CHANGE)

	2006	2007
REAL GDP	3.5	3.0-3.5
CORE INFLATION*	2.0	1.75-2.0
UNEMPLOYMENT RATE (4Q AVG.)	4.75-5.0	4.75-5.0

*PRICE INDEX, PERSONAL CONSUMPTION EXPENDITURES EXCLUDING ENERGY AND FOOD

Data: Federal Reserve

tighter now than when the Fed began lifting rates in June, 2004, despite the Fed's hikes in short-term rates, totaling 3½ percentage points. Not only do long-term rates remain low enough to support both housing and corporate borrowing, but the credit markets see less risk in lending now than when the Fed first started tightening. That's implied by the interest rate spread between corporate bonds and riskless Treasury bonds, which is narrower now than it was then.

And banks continue to be aggressive in seeking out new borrowers. The Fed's January survey of bank senior loan officers shows that banks continue to ease the terms and conditions on commercial and industrial loans to businesses. Also, the survey indicated that banks are still not toughening up their lending standards on mortgage loans, despite reports of the Fed urging them to do so.

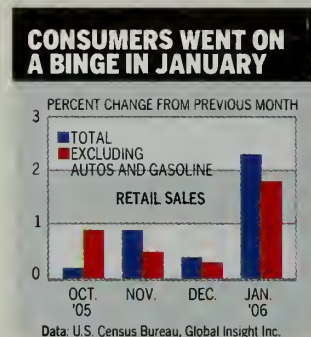
RELATIVELY EASY FINANCIAL CONDITIONS are one factor stoking U.S. demand in early 2006. Consumers got off to an explosive start this year, taking advantage of January's balmy weather and the redemption of all those holiday gift cards. The 2.3% jump in retail sales from December to January was the largest monthly gain since October, 2001, when sales were boosted by generous incentives by carmakers right after September 11 (chart).

The data mean that consumer spending and overall economic growth are rebounding with gusto this quarter, after the fourth quarter's weak showing. In fact, the strong start suggests that the Fed's latest forecasts for growth and inflation in 2006 might be too low (table, page 23).

Those numbers also imply that a lot of that demand will be going abroad, placing additional pressure on the trade deficit and the need for foreign capital to finance it. Two other globalization issues might also create problems for the Bernanke Fed. One is the growing threat of protectionism. Congress seems likely to consider the

bill by Senators Charles Schumer (D-N.Y.) and Lindsey Graham (R-N.C.) to impose a 27.5% tariff on all Chinese imports, perhaps within the next month or two. That would effectively raise import prices and nudge up overall inflation.

The other is the likelihood of a renewed decline in the dollar. The economic fortunes of



both Japan and the euro zone are turning up. More Japanese and euro zone savings will be staying at home, even as both economies attract more foreign investment. That leaves fewer global funds going to U.S. assets, which would cause the dollar to weaken.

Given the new global interdependency across economies, a full-blown dollar crisis seems unlikely, but a renewed dollar decline would generate some additional inflation pressures in the U.S. via higher import prices, giving the Fed yet another global issue to work around.

THE DOLLAR

Less Foreign Capital Than Meets the Eye

THE U.S. TRADE deficit hit a record last year, but foreigners invested more than enough in U.S. stocks and bonds to cover the gap. That's why the U.S. dollar didn't tumble. However, those supportive inflows are not as large as believed and are unlikely to last, leading to a probable retreat in the greenback this year.

On Feb. 15, the Treasury International Capital (TIC) report showed that U.S. securities purchased by investors and government agencies overseas minus U.S. purchases of foreign securities was \$56.6 billion. In 2005 the total net inflow was \$910.7 billion, far more than the trade gap of \$725.8 billion.

The Treasury Dept.'s monthly data

are increasingly popular as a sign of the ability of the U.S. to meet its external financing obligations, because they come out more often than the quarterly data from the Bureau of Economic Analysis. But the TIC report is not as comprehensive. For example, it excludes flows involving securities with a duration of less than a year. As a result, net inflows were overreported by an

average of \$20 billion per month through the first three quarters of 2005, say economists Jens Nordvig and David Heacock of Goldman, Sachs & Co.

The TIC report is also a little fuzzy on money from private investors vs. official institutions, such as central banks. The

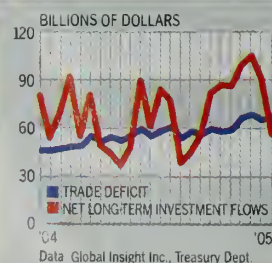
Treasury Dept. categorizes inflows based on who makes the transaction. So a central bank move made through a nongovernment third party would be counted as a private transaction.

Given that inflows are smaller than reported and that more of them are controlled by foreign central banks, the risks of a weaker dollar appear to be greater. Stronger economies in Japan and South Korea, pressure on China to let the yuan appreciate further, and the chance of greater diversification of foreign reserves among central banks all point to reduced demand for U.S. assets.

Making matters more delicate: Until December, "inflows accelerated beyond their longer-term trend" over 2005's second half, says Nordvig. Net inflows don't persistently outrun trade deficits. The smaller December total may be the start of a correction that touches off the dollar's decline.

—By James Mehring in New York

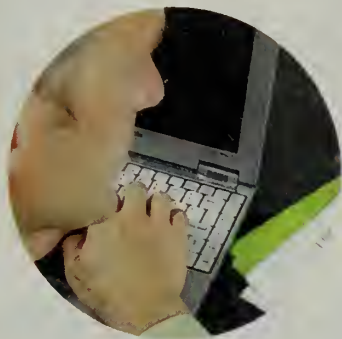
FOREIGN INFLOWS COOL DOWN



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The Business Week

News you need to know

EDITED BY HARRY MAURER



A Gold Medal Quarter? After slowing late last year, the U.S. economy is accelerating in 2006 like a four-man bobsled on a straightaway. Some experts figure first-quarter growth may exceed a 5% annual rate, up from the 1.1% initially reported for the fourth quarter of 2005. Both consumers and business seem revved up: On Feb. 14 the **Commerce Dept.** said retail sales grew an eye-popping 2.3%, seasonally adjusted, from December to January, aided by the warmest January on record. And on Feb. 15 the **Fed** said factory output rose a solid 0.7% in January.

This means the Fed will likely lift the federal funds rate another quarter point, to 4.75%, at its Mar. 27-28 meeting, the first with **Ben Bernanke** as chairman. Bernanke played it cool in Feb. 15 testimony, simply saying "I concur" with the Greenspan Fed's statement that more tightening may be what the economic doctor ordered.

See "What's Complicating Bernanke's Balancing Act," page 23, and "Chairman Bernanke Goes Up the Hill," www.businessweek.com/go/tbw

Where Are the Oil Rigs? The Gulf of Mexico ought to look mighty good to oil companies these days. Even with oil below \$58 a barrel on Feb. 15, the lowest close in nearly two months, and natural gas costing less than half what it did in December, prices remain high enough to support risky ventures. And as *The New York Times* revealed on Feb. 14, the industry will benefit from an estimated windfall of \$7 billion over the next five years from a policy that lets

producers off the hook for royalties. So how come there are only 75 rigs at work in the Gulf, down almost 25% from year ago, according to **Baker Hughes**? Partly we can thank Misses Katrina and Rita, but a major factor is overseas competition for ocean rigs. For now, Washington's price incentives probably won't spark much new supply.

Merrill Unloads a Unit Is money management more trouble than it's worth? **Merrill Lynch**, which said on Feb. 1 that it's selling its asset management unit to **BlackRock**, apparently thinks so, and other banks and brokerages could soon take the same path.

See "Money Managers on the Block," page 3

A Trade Spat Decision *Touché!* Score one for the **European Union** in its decade-long duel with Washington over how the U.S. taxes exporters. On Feb. 13 a **WTO** appeal panel ruled that certain tax breaks are illegal. The downside for U.S. business: Exporters of products such as textiles, steel, and electrical machinery could be skewered with up to \$4 billion in Euro-tariffs. The upside: Most of the \$145 billion in breaks that Congress O.K.'d in 2004—the last time it tried to fix the export-tax mess—will stick. The U.S. has three months to appeal.

The New Beat in Music Download fever: That's the tune industry execs dance to these days. **Warner Music** said doubled downloads helped hike first-quarter net by 92% while overall music sales fell by 2% as folks shied away from CDs. And **RealNetworks** boogied to a record \$325 million in annual revenues thanks to 50% more downloads and subscription sales through its **Rhapsody** service.

See "RealNetworks is Game for Games" www.businessweek.com/go/tbw

Buffett Bows Out No one can accuse **Warren Buffett** of being a shrinking director. In his 17 years on the **Coca-Cola** board, he helped shove two struggling CEOs into early retirement and engineered an 11th-hour veto of a deal to buy **Quaker Oats**. But on Feb. 14 the 75-year-old investment legend announced plans to step down in April. (He'll hang on to **Berkshire Hathaway's** 8.4% stake.) Buffett is pushing **Gillette CEO James Kilts** as his successor, though with former **Dow Chemical CFO Pedro Reinhard** and **SunTrust Banks** executive **Maria Elena Lagomasino** also set to step down in April, leaving Coke with only two minorities on its board, the beverage giant may decide that diversity is it.

Horie's Annus Horribilis The former CEO of once trendy Internet portal **Livedoor** may be hearing another kind of door clang shut behind him. Japan's 33-year-old Net guru, **Takafumi Horie**, was indicted on Feb. 13, together with the former CFO and two others, for allegedly cooking the books. Horie could face fines and prison time. Since **Livedoor's** collapse began on Jan. 16, it has lost \$6 billion or 90%, of its market cap and will probably be delisted from the Tokyo Stock Exchange.

Google's Swoon Bulging bank accounts in Silicon Valley look a mite slimmer because of sinking Google shares. After a torrid 2005, in which the search titan more than doubled to a peak of 475 on Jan. 11, the stock has plunged 2%, closing at 342 on Feb. 15. Investors changed their minds after weak fourth-quarter numbers made them look closely at Google's dependence on search. Still, at a market cap of \$101 billion, the company's valuation has clicked up more than 300% since its IPO 18 months ago.

Firing a Shot at China A valentine it wasn't. On Feb. 1, U.S. Trade Representative Rob Portman issued a report that marks a rare break in the Bush Administration effort to cool anti-Chinese rhetoric. Portman says China refuses to play by trade rules, so the U.S. will ratchet up pressure on Beijing to curb piracy, cut hidden subsidies, and open its own markets. The report came just days after word that the U.S. trade deficit hit a record \$725.8 billion in 2005, including a \$116.6 billion gap with China. Portman didn't ask for new powers to retaliate, so his latest isn't likely to blunt Capitol Hill's push for more sanctions.

See "China's Changing Economic Balance," www.businessweek.com/go/tbw

HP Wows the Street It's been a year since the ouster of Carly Fiorina, and new Hewlett-Packard CEO Mark Hurd is making the most of what she left for him. Crisp restructuring and smoother operations helped HP blow past Street expectations for its first quarter, posting 30% brawnier profits. Hurd has also nabbed new talent and has segments such as laptops and photo printing gear steaming. The stock jumped nearly 4% in after-hours trading on Feb. 15.

Blitz of the Week

Is he a legion of enemies like to call him Dr. Evil, but that doesn't stop Richard Berman. The Washington lobbyist and PR maestro for the fast-food industry just launched the Center for Union Facts, an attack Web site. While he won't name his backers because "we are talking about union people who have allegedly been involved in crime in some cases, so nobody wants to be targeted," Berman took out full-page ads on Feb. 14 intended to stymie labor's stepped-up recruitment. His theme: Many unions are corrupt and fail to benefit members. The in-your-face campaign is targeting Berman. Over the years the cigar-chomping ball of fire has helped liquor makers go after Mothers Against Drunk Driving for proposing stiffer alcohol limits for drivers and raged against minimum wage hikes for the National Restaurant Assn. Last year he assailed the "food police" in a drive for soda makers that targeted "obesity myths." Harsh? Sure. Why shouldn't Big Business have its own Michael Moore?



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STOCKS

HOW THE IPO MARKET GOT ITS BUZZ BACK

Hungry investors are making 2006 the busiest year for new issues since the tech crash.

BY AARON PRESSMAN

CHIPOTLE MEXICAN GRILL Inc. is used to seeing customers line up for its burritos, but at the end of January the McDonald's Corp.-owned chain experienced an even bigger rush. In an initial public offering, Chipotle's shares jumped from 22 to 44 in one day, the first time since 2000 that a U.S. IPO of more than \$10 million had doubled so quickly.

Investors' appetite for IPOs isn't limited to Chipotle. With 32 offerings priced since Jan. 1, up 14% from the same time last year, 2006 is shaping up to be the busiest year for new issues since before the tech crash.

And IPOs are performing well in the aftermarket. They returned an average of 18% in 2005 and 10% so far this year, according to Renaissance Capital in Greenwich, Conn., vs. returns of just 5% and 1%, respectively, for the

Standard & Poor's 500-stock index.

How warm are things getting? Eight of this year's deals have been priced higher than underwriters had anticipated, vs. three to this point last year. "The market is off to a very healthy start," says Craig Farr, co-head of U.S. equity capital markets at Citigroup.

NO MOOD TO QUIBBLE

PERHAPS TOO HEALTHY, say some observers. The downside to a strong IPO market is dumb deals—and they're here. The offering of shoemaker Crocs Inc. on Feb. 8 showed investors turning a blind eye to glaring problems. Another upcom-

ing IPO, that of Internet telephone provider Vonage, seems shaky, too.

But investors, grappling with the sideways stock market of the past 27 months aren't in a mood to quibble just yet. It's not only the number of offerings that's grabbing their attention but also the kinds of companies going public. Many are so-called reverse leveraged buyouts—former poor performers that were bought up by private equity firms betting they could fix them up and sell them back to the public for a profit. The top performers recently have been fast-growing upstarts such as Chipotle, Baltimore-based clothier Under Armour, and Latin American

steel company Ternium, all of which are seeing rapid sales and earnings increases. There has been a "return to the traditional growth IPOs," says Citigroup's Farr. That's good news, of course, for corporations looking to raise money. And when promising companies have an easier time

Three Hot Sectors for 2006

RESTAURANTS

McDonald's Chipotle spin-off encourages the likes of Morton's to follow

ENERGY

Persistently high commodity prices make going public attractive

HEALTH CARE

Amid fears of an economic slowdown, the sector looks like a defensive play

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Class actions: Big investors are opting out

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The political fallout if housing goes south

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Why banks are fleeing money management

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Britain's Tesco boldly leaps across the pond



forming capital, the economy as a whole benefits.

It was a long winter, though. When the bear market began, unprofitable startups with shaky business plans fell out of favor. Instead, well-established companies generating lots of cash, such as Kraft Foods Inc. and Genworth Financial Inc., stole the spotlight. The percentage of profitless IPO companies fell from 80% during the tech boom to 40% during the bust, and has stayed there. The average age of companies going public shot up from four years in 1999 to 15 in 2002, according to research by University of Florida finance professor Jay Ritter. Investors, in other words, gave money only to companies already demonstrating that they deserve it.

The reverse leveraged buyouts were received particularly well, making up about 40% of all IPOs in 2003 and 2004. Most of those companies were in good standing and had been managed smartly while in private hands. Now, with growth companies back in vogue, reverse LBOs are making up a smaller percentage of deals. The average age of companies going public slipped to 11 in 2005, and it's heading lower.

WORRISOME DEBUTS

BUT THAT'LL LIKELY be only a temporary phenomenon. The private-equity market has been booming (page 52), with huge investment inflows fueling more and bigger LBOs. Assuming the IPO market stays strong, the reverse LBO pipeline should soon be gushing.

Observers worry, however, about the Feb. 8 offering of Niwot (Colo.)-based shoemaker Crocs. Yes, the company's financial outlook seems strong, with a 2004 net loss of \$1 million turning into a \$13 million profit for the first nine months of 2005. But Crocs went off for almost 10 times its revenues, a staggeringly high multiple. And material in its filings with the Securities & Exchange Commission gives reason for pause. The company found "material weakness" in its internal controls during its most recent audit, according to the filing. The filing also showed that Crocs has instituted takeover defenses to protect management. And it has a history of consulting deals with companies controlled by officers. Crocs declined to comment.

Also on Feb. 8, Internet telephony provider Vonage Holdings Corp. filed to go public, despite posting a net loss of \$190 million in the first nine months of 2005. The company said it wants to

STYLISH MOVE
J. Crew's IPO is expected in the next few months



Ready to Roll

How five expected IPOs stack up

	INITIAL PUBLIC OFFER MILLIONS	REVENUES MILLIONS*	NET PROFITS MILLIONS*
MasterCard	\$2,450	\$2,222	\$320
Pacific Airport Group	954	175	63
Tim Hortons	600	1,078	175
J. Crew	355	663	-0.4
Vonage Holdings	250	174	-190

* For most recent nine-month period

Data: Companies

raise \$250 million, but it hasn't disclosed how many shares it will sell or what the company's total value will be after the deal. Its business plan emphasizes market share growth over profits and cash flow. Skeptics point out that what's really growing are Vonage's expenses and customer acquisition costs, which are rising faster than revenue. Vonage declined to comment, as did Citigroup's Farr, whose firm is underwriting the offering. "Investors need to take some responsibility for due diligence," says Lynn Turner, managing director of research at independent research firm Glass Lewis & Co. and the former chief accountant of the SEC.

For the most part, however, the business models of successful IPOs have been decidedly 21st century. Energy and health-care issues have been plentiful.

But the hottest niche by far has been consumer-oriented companies, especially restaurants. Despite fear that Americans are tapping out, retailers and restaurant operators have been thriving. Chipotle's net loss of \$17 million in 2004 swung to net income of \$33 million in the first nine months of 2005. Clothing Under Armour, meanwhile, posted revenues of \$194 million in the first nine months of 2005, triple the 2002 level, and a net income of \$14 million, five times the 2002 amount.

Investors paid a premium for those brands, and their success has encouraged followers. Steakhouse chain Morton's Restaurant Group Inc. raised \$161 million on Feb. 9, while Ian Schrager's hip hotel chain Morgans Hotel Group Co. garnered \$360 million on Valentine's Day. Among the hotly anticipated issues are MasterCard, Wendy's doughnut-chain spin-off Tim Hortons, Mexican airport operator Pacific Airport Group, and retailer J. Crew Group, all expected to offer shares in the next few months. Burger King Corp. has said it will file soon, and Levi Strauss & Co. might file this year.

"The consumer confidence and spending numbers have been so good," says Chad Abraham, head of equity capital markets at Piper Jaffray Cos. in Minneapolis. "Investors are looking for ways to play that." The trend shows no sign of slowing: The Commerce Dept. reported on Feb. 14 that January retail sales increased 2.3%, the biggest monthly gain in almost two years.

With saner practices and mostly solid offerings, the IPO market seems to be on solid ground. Activity could slow if the broader stock market tumbles; falling equity prices last March and April hurt new issues, as did Hurricane Katrina later in the year. But for now, the business is healthy. Finally, there's some demand out there for growth stories, especially for companies selling burritos or T-shirts. ■

—With Michael Arndt in Chicago

LWSUITS

FRACTURED CLASS ACTIONS

"Opt-outs" are a growing headache for companies

ERRAINE WOELLERT

WHEN TIME WARNER Inc. said it would spend \$2.4 billion to settle an investor class action alleging securities violations, chairman and CEO Richard D. Parsons said that the company had made swift work of its litigation woes. "By acting on these matters behind us, we have reduced the costs and distractions of protracted litigation," he said in August. So fast. Even as a federal judge pressures the company to give final approval to the deal on Feb. 8, it could be some time before Parsons can rest easy. Giant shareholder Capital Group Inc., which owned 10% of Time Warner and over 3% of America Online when the companies announced their merger in September, is pursuing its own settlement, *BusinessWeek* has learned. So are several pension accounts and more than 100 other institutional investors with alleged losses ranging from less than \$100,000 to more than \$500 million. All are exercising their right to opt out of a class settlement in hopes of winning more money by going it alone. Plaintiffs' attorney William S. Lerach is at the forefront of what has become the most headache for defendants in securities cases. No hard statistics are available, but opt-outs appear to be a more popular tactic for plaintiffs' lawyers. "There's no doubt that the numbers are up," says Stanford Law School's Joseph A. Grundfest, who monitors the litigation. Lerach, founding partner of San

Diego's Lerach Coughlin Stoia Geller Rudman & Robbins LLP, was among a handful of lawyers dominating such suits more than a decade ago, when firms seeking to win control of a big case—and the resulting fat paycheck—simply had to race to the courthouse to be the first to file a suit. Lerach and a few others had the practice down to such a science that the Justice Dept. is investigating whether they paid kickbacks to plaintiffs. Lerach has denied wrongdoing.

In 1995, Congress rewrote the rules, making it harder for the small coterie of securities fraud plaintiffs' attorneys that had dominated the business to continue

LAWYER LERACH
His clients sue separately to win more cash

doing so. That's one key reason why Lerach is frequently trying another tack: detaching from class action settlements negotiated by others and striking out on his own.

While Lerach has helped hammer out plenty of class-wide deals in his time, he now lauds the virtues of opting out. "Why should investors sit passively by and take a couple cents on the dollar?" he says. "This is an extraordinarily powerful tactical weapon."

The trend is causing concern in courtrooms and boardrooms. On Feb. 8 a federal judge in New Jersey postponed approval of a \$195 million settlement between KPMG International and tax shelter investors because more than 60 of the

284 investors had chosen to pursue their own litigation. Cheryl L. Evans, special counsel for the U.S. Chamber Institute for Legal Reform, says opt-outs increase costs for companies. "When you have this fragmentation, companies are paying to settle several cases when it's more efficient to work on one front," she says.

BETTER RETURNS

LAST YEAR, LERACH got 65 clients, including several state pension funds, to bypass a \$6.1 billion settlement of claims against banks for WorldCom Inc. The group reached a \$651 million deal. Now he's persuaded 93 funds to seek separate lawsuits against Time Warner.

Edward I. Adler, executive vice-president of Time Warner, calls the number of opt-outs "very, very small." Lead class counsel Samuel D. Heins of Minneapolis-based Heins Mills & Olson PLC says the settlement has drawn a negligible number of complaints from class members. Time Warner has set aside \$600 million to wrap up its remaining liability, but the growing roster of opt-outs could force that number up.

There's always a risk that breakaway investors could do worse by striking out on their own, but there's enough evidence to the contrary to keep fueling the trend. When the California Public Employees' Retirement System quit the WorldCom deal, it recovered \$187 million, or 67% of its claimed bond losses, Lerach says. New York City Pension Funds also opted out of WorldCom, recovering close to 100% of losses, its lawyers say. The final return for WorldCom class members remains to be seen, but it's expected to be far less. ■

Taking A Pass

Examples of big investors that opted out of class-action settlements

Enron \$7.1 BILLION OPT-OUTS AIG, Alabama and Ohio state pension funds	WorldCom \$6.1 BILLION OPT-OUTS SunTrust Banks, New York City pension funds
Time Warner \$2.4* BILLION OPT-OUTS Janus Capital and nearly 100 other institutional investors	Qwest Communications \$400 MILLION OPT-OUTS State Univ. Retirement Systems of Illinois, Calif. State Teachers' Retirement System

*Awaiting court approval

COMMENTARY

BY MICHAEL MANDEL

Who Gets Blamed If the Roof Caves In

A tumble in housing prices would cause voters more pain than falling wages



WHEN THE HOUSING boom finally goes bust, the real political battles for the 2006 and 2008 elections will begin. That's my conclusion as I watch Democrats struggle to score economic points against the Bush Administration. Real wages are falling, and many Americans are scared of globalization, issues that should play well for the



Democrats. But their attacks aren't resonating with voters, in large part because of the rosy glow of housing-induced prosperity.

To see why the housing market matters so much, let me introduce you to the typical American worker. He or she is 35 to 44 years old and has less education than you probably realize, with some exposure to college but without even a two-year degree. These folks have seen a decline in real wages since President George W. Bush took office. Between 2000 and 2004, real earnings for such workers fell by 2.4%, or about \$1,100 a year. That's why many Democrats think that they should be doing better in the polls.

But wait. The typical American also owns a house. Homeownership climbed from 67% in 2000 to 69% today. Toss a wad of paper into a crowd, and you are likely to hit someone who is paying a mortgage or grouching about real estate taxes. For these people, declining wages are less important than low interest rates and rising home prices. Let's run some numbers.

In 2000 the average interest for a new 30-year mortgage about 8%. From 2003 to 2004, however, a homeowner could only get a 30-year rate of less than 6%, well below the lowest rate available in the 1990s. As a result, almost everyone could cut their interest costs by refinancing. For example, if you had a \$150,000 mortgage at 8% in 2000 and refinanced to a 6% mortgage in 2004, your interest payments on that house would have dropped by roughly \$3,000 a year.

Thus, many Americans may be seeing a pretax gain from lower interest payments that more than compensates for the decline in wages. And we haven't yet factored in soaring home values, up about 33% over the past five years, after adjusting for inflation. No wonder most voters, while worried, still have turned totally pessimistic.

That's why the Democratic response to a housing slump, especially if the bottom falls out of the U.S. market, could be politically crucial. What could the party offer? Democrats could start thinking about ways to ease the country's bankruptcy to help homeowners whose house values have dropped sharply, suggests Kashif Mansori, an economist at Colby College in Waterville, Me., who is one of the main posters on liberal blog Angry Bear (angrybear.blogspot.com). Another possibility, he notes, is "more favorable tax treatment for people who have suffered capital losses on their house."

By contrast, Robert Atkinson, vice-president of the Progressive Policy Institute, the research arm of the centrist Democratic Leadership Council, wouldn't try to cushion a bust. Instead, with a lot of people currently locked out of the market by extremely high prices, says Atkinson, "I would figure out how to reduce barriers, especially zoning and planning restrictions that keep more homes from being built."

How Dems respond to a bust could shape the 2006 election

Of course, Republicans won't be standing still in the event of a housing downturn. The Bush administration is likely to push harder for tax cuts to help Americans who can no longer draw their home equity. After the book is history, political supremacy in Washington may well depend on which party can best reassure worried American homeowners.



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THE BOARDROOM

THE RISING STOCK OF BLACK DIRECTORS

Corporations look to broaden their boards beyond big names like Parsons and O'Neal

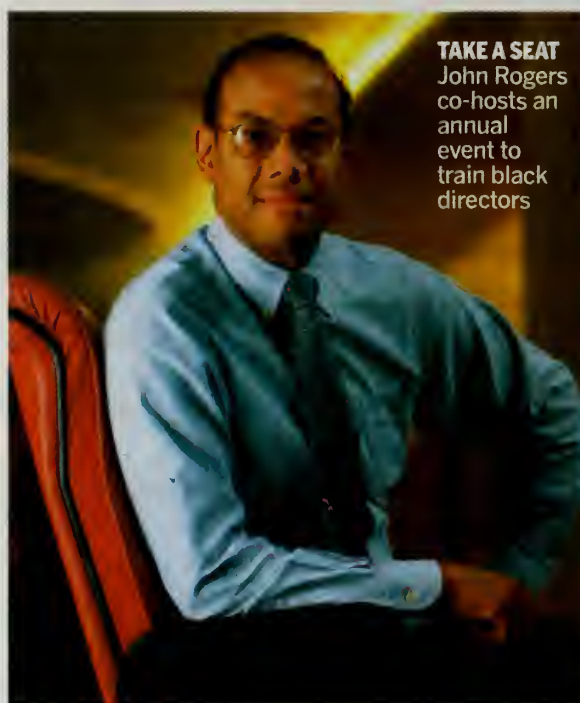
BY ROGER O. CROCKETT

MERRILL LYNCH & CO. CEO E. Stanley O'Neal had barely resigned from the General Motors Corp. board on Feb. 6 before GM began thinking about recruiting another African American to fill his slot.

Typically, a corporation like GM would look to replace him with another marquee African American name. Someone like Time Warner CEO Richard D. Parsons, who sits on the Citigroup, Estee Lauder, and Time Warner boards. But in an era of stepped-up corporate governance, CEOs are taking on fewer directorships.

That's prompting companies to broaden their reach beyond the likes of O'Neal and Parsons. As it happens, there's a large pool of black directors from which to choose. You may not have heard of these folks. But at a time when many markets are fragmenting along ethnic lines, African American directors are increasingly sought-after. According to executive recruiter Spencer Stuart, 162 black directors sit on the boards of the top 200 S&P 500 companies. That's double the number in 1987, says the Executive Leadership Council (ELC), which promotes board diversity. "A diverse board translates into a more profitable business," says Patrick G. "Pat" Ryan, executive chairman of Aon Corp., which has a black man, an Hispanic woman, and an Asian American woman on its board. "There's no doubt about it."

Recruiting firms such as Spencer Stuart are scouring the country to uncover African



TAKE A SEAT
John Rogers co-hosts an annual event to train black directors

seen boards look at a list in a black magazine and say, 'I want No. 32,'" says John Hembrook Daum, who leads Spencer Stuart's U.S. board practice. "But there are all of people that don't appear on those lists

"EXTRAORDINARY OPPORTUNITY"

PERHAPS THE MOST prominent member of this second tier of African American directors is John W. Rogers. The founder and CEO of Ariel Capital Management, a Chicago mutual fund, Rogers was appointed to the Aon board in 1993, when he was just 35. "It was an extraordinary opportunity to learn from the best," he recalls. Today, Rogers also sits on the boards of McDonald's, Exelon, and Bally Total F

ness. Besides advising on investment and audit committees, Rogers co-hosts an annual event to train scores of black directors. "If a board doesn't have black directors to get issues on the table," he says, "it's not doing its job."

Another African American named Rogers has emerged as a director to watch. Steven Rogers, a former entrepreneur who teaches at the Kellogg School of Management, became a director at Johnson & Son Inc. in the late '90s. Then-CEO William Perez took a risk since Rogers was 41 and lacked major board experience. But Perez was so taking Rogers' advice—for example, investing in venture capital firms that backed black businesses. "It's not

THE STAT

84%

Proportion of top 200 S&P companies with at least one African American director

Data: Spencer Stuart

American talent. Since 2000, the recruiter has placed 277 women and 150 minority candidates on boards. Recruiters often work with Washington (D.C.)-based ELC, a rich source of largely untapped talent. Telecom giant Verizon Communications Inc. recently lured ELC member Clarence Otis Jr., the 49-year-old CEO of Darden Restaurants, to serve on its board. And Donna A. James, 48, presi-

dent of the strategic investments unit of Nationwide Mutual Insurance Co., is gaining notice as a director at Coca Cola Enterprises Inc. and Limited Brands Inc. "I've

like I fell off the watermelon truck," says Rogers, who is also a director at SuperValu and Amcor Financial. "Boards sometimes have to go outside their normal blueprint to find people."

When Arbitron Inc., the radio-industry researcher, was looking for a black perspective, it made Shellye L. Archambeau a director. The CEO of San Francisco business software maker MetricStream Inc. isn't a big name. But she has operating experience and technology expertise, both skills Arbitron needed. Plus, she adds a fresh point of view about the data Arbitron produces for its minority-owned media customers. "It's important to have someone on the board [who] understands that," says Philip Guarascio, chair of the board's nominating committee. "It adds to the richness of the discussion."

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WALL STREET

MONEY MANAGERS ON THE BLOCK

Banks and brokerages are selling, and plenty of deep-pocketed bidders await

BY MARA DER HOVANESIAN

A MONEY MANAGEMENT outfit is a great business to own—except for a bank or brokerage. That's the lesson from the recent news that Merrill Lynch & Co. Chief Executive Stan O'Neal is merging the company's \$539 billion asset management unit into BlackRock Inc., run by CEO Laurence D. Fink. For BlackRock the move represents a chance to diversify its bond management business into equities. Merrill takes a near 50% ownership stake in a lucrative and growing business with \$1 trillion in assets under management.

Wall Street watchers expect more deals soon. Still reeling from the aftermath of a mutual fund scandal in 2003 that shined a harsh light on the practice of retail brokers pushing their firm's mutual fund products over

those of others, many companies are deciding that owning a money management unit is more trouble than it's worth. True, money managers enjoy some of the highest profit margins in financial services. And, with baby boomers retiring just over the horizon, growth prospects look excellent. But these days, "if an investor asks, [companies] have to tell them they give their brokers higher payouts and Ferraris to sell in-house products," says Eric C. Weber of Freeman & Co., a boutique mergers-and-acquisitions advisory firm. "Investors don't like that."

O'Neal isn't the first Wall Street big shot to want out of money management. In December, Baltimore's Legg Mason Inc. bought Citigroup's \$437 billion asset management business in exchange for its

brokerage in a \$3.7 billion deal. "The biggest retail brokerage distribution companies in the world have done same thing," says Gary Shedlin, investment banker in Citigroup's financial institutions M&A group, which advised BlackRock on the Merrill Lynch negotiations. "This deal is affirmation of a long trend that will continue."

The only question seems to be which company will be the next to bail out and merge. Many think it will be Morgan Stanley, which has a large brokerage franchise and was outbid by Merrill for BlackRock. Don Putnam, managing partner of Boston-based consulting firm Grail Investors LLC, expects three or four more brokerage firms and banks to sell off their asset management units in the next months. Among them: Bank of America Corp. and Wachovia Corp. Insurer MetLife & McLellan might also want to unload Putnam fund business, while Mellon Financial could sell Dreyfus.

WHO'S ON THE PROWL?

BUYERS ARE IN the wings. JPMorgan Chase & Co., which has no retail brokerage unit, intends to build the company money management group partly by acquisition. Another promising bunch of publicly traded asset managers. These firms are "generally flush with cash, many are looking for incremental acquisitions to fill out product lines," says Keefe Bruyette & Woods Inc. analyst Robert Lee. One company that may

be on the prowl, Lee says, is San Mateo (Calif.)-based Franklin Resources Inc.

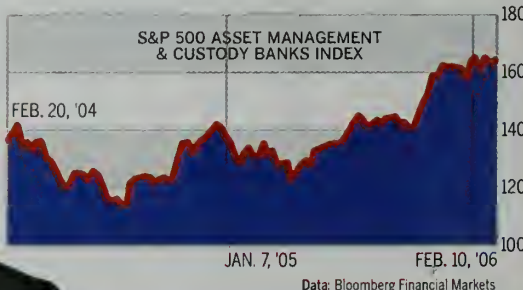
Already, deal volume is up. By mid-2005 transactions, as measured by assets under management, were at the highest since 2001, with 83 companies and \$755 billion in global assets acquired, according to Freeman & Co. But there's a downside to deal mania. Talented money managers are getting fed up with all the hand trading and starting their

own firms. "For all the jockeying for position, there's going to be a lot of friction," says David Silvera of Rosen Investment Partners LLC, an investor in private equity firms that specializes in asset management firms. Managers "want to be masters of their own destiny. They don't see the benefit of being part of a larger group." Let the buyer beware.

—With Lauren Young in New York

HOT PROPERTIES

Mergers and acquisitions, plus big cash inflows, are sending the stocks of public asset managers soaring



BLACKROCK'S FINK

The Merrill deal adds equities to his firm's bond management



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SUPERMARKETS

TESCO: CALIFORNIA DREAMING?

The British retailer is counting on high tech to crack the U.S. convenience market

BY KERRY CAPELL

IT WAS A COVERT OPERATION. A year ago, when giant British retailer Tesco was planning its foray into the U.S. market, the company dispatched an advance team of senior managers stateside. This was no routine intelligence-gathering trip, though. Hoping to keep their plans secret from rivals, the Tesco executives posed as Hollywood film producers making a movie about supermarkets. The operatives set up a trial convenience store in a West Coast warehouse. Loath to leave a paper trail that could tip off competitors, they used plastic bags of cash rather than corporate charge cards to buy goods for their mock store.

The result was a huge surprise for the U.S. retail industry. On Feb. 9, Tesco CEO Sir Terry P. Leahy announced that the world's No. 5 retailer will spend \$453 million to open a chain of convenience stores on the West Coast next year.

On the face of it, the move sounds not only bold but harebrained. European chains have long tried, mostly unsuccessfully, to make inroads into the U.S. Meanwhile many U.S. retailers, squeezed by rising costs and big-box players such as Wal-Mart Stores Inc., are scaling back or selling out. Operating a store in the U.S. these days is not for the fainthearted.

If that all weren't daunting enough, Tesco will be starting from scratch, with no brand recognition, no customers, and no distribution system in place. There's even new competition to worry about. This month, Home Depot Inc. is launching a chain of gas-station convenience stores called Home Depot Fuel. Canada's Alimentation Couche-Tard Inc. is expanding in the U.S., where it already has 3,000 outlets, including those under the Circle K name. Industry leader 7-Eleven Inc., which was acquired by a Japanese af-

filiate last year, is upgrading. "Going from zero to a well-known brand in any country takes a long time, but in the U.S. it will take a lot longer," says Jonathan Pritchard, food retail analyst at Orion Securities Ltd. in London. Tesco executives were not available for comment.

GLOBAL BUYING POWER

YET TESCO IS a powerhouse in Britain where it has blunted Wal-Mart's drive to dominate the retail scene. Wal-Mart's superstore format has been outflanked there by a swarm of Tesco stores, from huge emporia to tiny express shops. Today the company controls more than 30% of the grocery market in Britain, a fact that has led Wal-Mart, which operates under the name of ASDA Group Ltd. in Britain, to call for a government investigation of its rival. Tesco has been expanding in Eastern Europe and Asia. And like Wal-Mart, it used its global buying power to achieve operating margins last year of 5.7%, just under Wal-Mart's 5.9%.

High tech is another Tesco strong point. It runs the world's biggest online grocery: British shoppers can even buy their groceries via cell phone. Tesco, like Wal-Mart, was an early adopter of radio frequency identification technology and other methods to get goods to stores in the most cost-efficient way. "Tesco is ruthless in supply chain management," says Scott Langdoc, vice-president of Boston consultancy AMR Research Inc.

Tesco will model its California outlets on its successful Express stores, a chain of 800 mini-supermarkets. The company, which operates some Express stores in conjunction with Exxon Mobil Corp., plans to go far beyond the traditional convenience-store format of gas, snacks, and smokes to include groceries, produce, and private-label ready-to-eat meals.

Is Tesco itching to mix it up with Wal-Mart on the American retailer's home turf? The British actually are targeting an area where Wal-Marts are relatively scarce. The Bentonville (Ark.) company has 266 stores in California, Oregon, and Washington, compared with 415 in Texas alone. Wal-Mart is experimenting with smaller-format Neighborhood Market stores, but these are more like supermarkets than convenience stores. "To grow, Wal-Mart needs to go beyond big stores," says Frank Badillo, director of global research and senior economist at consultancy Retail Forward Inc. in Columbus, Ohio. "Tesco is beating them to the punch."



Tesco At a Glance

REVENUES \$59 billion*

OPERATING PROFITS \$3.4 billion*

STORES 1,819 stores in Britain, 648 others in 12 countries in Europe and Asia

STRATEGY Offering reasonable prices for private-label food products, clothing, cell phones, home-entertainment gear, and financial products

SHOPPING EXPERIENCE Four types of stores: **Tesco Express**, a convenience chain; **Tesco Metro**, a large, city-based store; **Superstore**, up to 50,000 square feet with nonfood products; and **Extra**, one-stop hypermarkets up to nearly 200,000 square feet

*2005

Data: Company reports

In patients with type 2 diabetes and at least one other risk factor for heart disease

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It is also used in patients with type 2 diabetes and at least one other risk factor for heart disease such as high blood pressure, smoking or complications of diabetes, including eye disease and protein in urine, to reduce the risk of heart attack and stroke.

LIPITOR is not for everyone. It is not for those with liver problems. And it is not for women who are nursing, pregnant or may become pregnant.

If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of serious muscle side effects. Tell your doctor about all the medicines you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose. The most common side effects are gas, constipation, stomach pain and heartburn. They tend to be mild and often go away.

Please see additional important information on next page.

LIPITOR is one of many cholesterol-lowering treatment options in addition to diet and exercise that you and your doctor can consider.

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IMPORTANT FACTS



LIPITOR
atorvastatin calcium
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(LIP-ih-tore)

LOWERING YOUR HIGH CHOLESTEROL

High cholesterol is more than just a number, it's a risk factor that should not be ignored. If your doctor said you have high cholesterol, you may be at an increased risk for heart attack. But the good news is, you can take steps to lower your cholesterol.

With the help of your doctor and a cholesterol-lowering medicine like LIPITOR, along with diet and exercise, you could be on your way to lowering your cholesterol.

Ready to start eating right and exercising more? Talk to your doctor and visit the American Heart Association at www.americanheart.org.

WHO IS LIPITOR FOR?

Who can take LIPITOR:

- People who cannot lower their cholesterol enough with diet and exercise
- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

BEFORE YOU START LIPITOR

Tell your doctor:

- About all medications you take, including prescriptions, over-the-counter medications, vitamins, and herbal supplements
- If you have muscle aches or weakness
- If you drink more than 2 alcoholic drinks a day
- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C).

LIPITOR can lower the risk of heart attack or stroke in patients who have risk factors for heart disease such as:

- age, smoking, high blood pressure, low HDL-C, heart disease in the family, *or*
- diabetes with risk factor such as eye problems, kidney problems, smoking, or high blood pressure

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
- **Liver problems.** Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.

Symptoms of muscle or liver problems include:

- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
- Nausea, vomiting, or stomach pain
- Brown or dark-colored urine
- Feeling more tired than usual
- Your skin and the whites of your eyes turn yellow

If you have these symptoms, call your doctor right away.

The most common side effects of LIPITOR are:

- Headache
- Constipation
- Diarrhea, gas
- Upset stomach and stomach pain
- Rash
- Muscle and joint pain

Side effects are usually mild and may go away by themselves. Fewer than 3 people out of 100 stopped taking LIPITOR because of side effects.

HOW TO TAKE LIPITOR

Do:

- Take LIPITOR as prescribed by your doctor.
- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

- Do not change or stop your dose before talking to your doctor.
- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
- Do not break the tablet.

NEED MORE INFORMATION?

- Ask your doctor or health care provider.
- Talk to your pharmacist.
- Go to www.lipitor.com or call 1-888-LIPITOR.



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EDITED BY RICHARD S. DUNHAM

Dirty Secrets of the 'Black Budget'

FORMER CALIFORNIA REPRESENTATIVE Randy "Duke" Cunningham's guilty plea to bribery and tax evasion exposed Washington's backroom ways, where gifts to lawmakers are sometimes followed by official actions that benefit the officeholder's benefactors. But Cunningham's intervention on behalf of companies

went far beyond the projects disclosed in court filings. Capitol Hill sources say Cunningham also delivered for the businesses he bribed him by slipping projects into his super-secret "black budget" that funds classified intelligence work.

The San Diego Republican's alleged actions cast light on one of the dirty secrets of Capitol Hill: Nothing—not even the spy budget—is exempt from lawmakers' "earmarks" designed to steer federal spending toward favored projects and recipients. "There's a general concern about transparency and oversight of earmarks in both the 'black' and the 'white' worlds," says John Scofield, spokesman for the House Appropriations Committee.

While the "white budget" is available for public inspection, the top-secret "black" is reserved for the annual intelligence-spending bill is kept in a secure room. Only a few staffers are allowed to work on it. Even the members of Congress who vote it into law aren't allowed to read the bill unless they are deemed to have a "need to know," a status limited to a few dozen who oversee the Pentagon and spy agencies. Legislators with access to the classified portion of the bill can earmark spending for favored projects and technologies, say multiple sources. "These guys can basically give money to whomever their heart desires, and we have no idea who's getting the money," says Keith Ashdown, vice-president of the conservative watchdog group Taxpayers for Common Sense.

The ethics scandals engulfing Washington have put the spotlight on earmarking by the congressional appropriations commit-

tees that control the nation's purse strings. Lobbyist Jack Abramoff, now a cooperating witness in a federal investigation, called the appropriations panels Washington's "favor factory." Senator John McCain (R-Ariz.) has launched a war on earmarking, saying the practice is ripe for corruption and drives up the federal deficit. The details are hard to dig out, though, because earmarks are often hidden in bills that run to hundreds of pages. And in the hush-hush intelligence world, unearthing earmarks is all but impossible. But classified pork "is just as wrong as any other earmark," says McCain. "In fact, it deserves extra scrutiny now because Duke Cunningham was able to perpetrate some of his egregious crimes through exactly that vehicle."

Indeed, Cunningham's intervention for San Diego-based defense contractor ADCS and Washington intelligence firm MZM so alarmed Hill leaders last summer that then-Appropriations Committee Chairman C.W. "Bill" Young (R-Fla.) ordered a probe to see what Cunningham put in the spy budget. The committee found that the projects were legitimate.

Total spending in the intelligence bill is confidential. People familiar with intelligence point out that secret earmarks represent an extremely small share of the \$27.3 billion spent on pet projects. Lawmakers are more circumspect about favoring special interests in the black budget, these sources say, in part because they can't send out press releases boasting of bringing home the bacon. One source says the bill includes fewer than 10 earmarks a year. Of course, there's no way to know for sure. It's classified. ■

—By Eamon Javers



CUNNINGHAM
Did he hide earmarks in the spy budget?

CAPITAL INSIDER

WANTED: A CEO TO RUN FOR THE WHITE HOUSE

AMERICANS would rather have a CEO as commander-in-chief than a politician. A Feb. 7-8 Fox News/Opinion Dynamics poll found that 33% of voters preferred a business leader for President, while a politician or general each were favored by 21%. Independents, at 42%, were the biggest CEO backers.

SENATE HEAT ON THE CREDIT RATERS

CREDIT-RATING agencies will be on the hot seat on Mar. 7, when the Senate Banking Committee plans hearings to consider tighter regulation of the raters. Corporate CFOs will urge lawmakers to bar the agencies (including Standard & Poor's, which, like *BusinessWeek*, is owned by The McGraw-Hill Companies) from offering consulting services to corporate clients whose debt they rate. Critics argue that creates potential conflicts of interest. But a spokesperson for S&P says: "We have policies, procedures, and firewalls in place to insure the independence and objectivity of everything we do."

AN IRS PHISHING EXPEDITION

NET SCAMMERS have been doing some especially nasty phishing lately: sending out e-mails under a legit-looking IRS logo that promise info about your tax refund. All you need do is send back your name, Social Security number, and credit-card details. An IRS spokesman wants you to know you can find the status of your refund at www.irs.gov and that the agency never asks for info by e-mail. And the IRS wants the scammer to know impersonating the taxman is a felony.

MAKEOVERS

ELECTROLUX
CLEANS UP

Boosting R&D and getting all units on the same page delivers a rebound

BY ARIANE SAINS
AND STANLEY REED

YOU WILL NEVER MEET Catherine, Anna, Maria, or Monica. But the future success of Sweden's Electrolux depends on what these four women think. Catherine, for instance, a type A career woman who is a perfectionist at home, loves the idea of simply sliding her laundry basket into a washing machine, instead of having to lift the clothes from the basket and into the washer. That product idea has been moved on to the fast track for consideration.

So just who are Catherine and the other women? Well, they don't actually exist. They are composites based on in-depth interviews with some 160,000 consumers from around the globe. To divine the needs of these mythical customers, 53 Electrolux employees, including designers, engineers, and marketers hailing from various divisions, gathered in Stockholm at the end of November for a weeklong brainstorming session. The Catherine team began by ripping photographs out of a pile of magazines and sticking them onto poster boards. Next to a picture of a woman wearing a sharply tailored suit, they scribbled some of Catherine's attributes: driven, busy, and a bit overwhelmed.

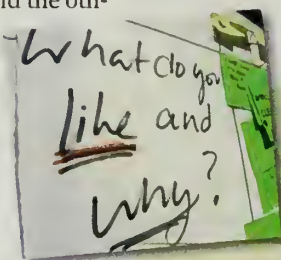
With the help of these characters, Electrolux designers and engineers are

searching for the insights they'll need to dream up the next batch of hot products. It's a new way of doing things for Electrolux, but then again, a lot is new at the company. When Chief Executive Hans Straberg took the helm in 2002, the world's No. 2 maker of home appliances after Whirlpool Corp. faced spiraling costs while its middle-market products were gradually losing out to cheaper goods from Asia and Eastern Europe. Competition in the U.S., where Electrolux gets 40% of its sales, was ferocious. The company's stock was treading water.

Straberg had no choice but to do something radical. He began shuttering plants in Western Europe and the U.S. and shifting work to lower-cost locales in Asia

and Eastern Europe. He also is spinning off the outdoor products division. But this is no ordinary corporate makeover. Straberg is also breaking down barriers between departments and forcing his designers, engineers, and marketers to work together to come up with new products. To speed the transition, he has recruited executives from companies with strong track records in innovation, including Procter & Gamble and PepsiCo.

At the Stockholm brainstorming session, for example, the group leader, Ki-



TAKE NOTE
Divisions brainstorm together

Electrolux' **Hit List**

The appliance maker's new emphasis on design is yielding a crop of products and hot prospects

CURRENT WINNERS

ICON CONVECTION WALL OVEN (\$2,000 and up) The ICON oven is outfitted with a glass door that doesn't get hot during cooking and racks that glide out smoothly thanks to a patented ball-bearing system.

PRONTO UPRIGHT VACUUM (\$99) This cordless vacuum with a detachable handheld is so attractive it doesn't deserve to be hidden away in the closet.

OXYGEN VACUUM (Around \$500) All controls on this canister model are on the handle, so there's no need to bend down.

HOT PROSPECTS

BREEZE HAND-HELD STEAMER This cordless device doubles as a stain remover. Comes outfitted with a scent dispenser.

GENTLE DRYER It's designed to leave clothes free of wrinkles and has a lighted yellow drum to simulate sunshine.

WATERLESS WASHING MACHINE This machine will use ultrasound, ultraviolet, or ion technology to clean clothes gently without water.

Data: Electrolux, BusinessWeek



TRY, TRY AGAIN
Refining a product prototype at the brainstorming session

is a recent P&G defector. She urges one "to think of yourselves as a machine." The room buzzes with discussion. Ideas are refined, sketches are drawn up. The group settles on three concepts: Breeze, a clothes steamer that also removes stains; an Ironing Center, similar to a clothes press but for shirts; and Ease, a washing machine that holds a laundry basket inside its drum.

If the group races off to the machine room to turn out a prototype for Breeze, the rest stay upstairs to bang out a marketing plan. Over the next hour, designer Lennart Johansson carves and shapes a block of peach-colored polycarbonate until a contraption that resembles a cross between an electric drill and a handheld vacuum begins to emerge. The designers in the room want the Breeze to be smaller, but designer Giuseppe Frucco points out that it would leave too little space for a rotating station for the 1,500 watt unit.

For company veterans like Frucco, who works at Electrolux' fabric care research and development center in Porcia, Italy, this dynamic groupthink is a refreshing change: "We never used to create new products together," he says. The designers would come up with something and then tell us to build it." The new way saves time and money by avoiding the technical glitches that crop up as a new design moves from the draft-

ing table to the factory floor.

To support the innovation drive, Straberg has bumped up spending on R&D from 0.8% of sales to 1.2% and is aiming for 2% eventually. What he's gunning for are products that consumers will gladly pay a premium for: Gadgets with drop-dead good looks and clever features that ordinary people can understand without having to pore through a thick users' manual. "Consumers are prepared to pay for good design and good performance," he says.

Electrolux isn't the only appliance maker on an innovation kick. In 1999, Whirlpool Corp. launched a program that allows all of its 68,000 employees to contribute design ideas, yielding a flood of new products.

EYE-CATCHING DESIGN

BUT FEW HAVE pulled off the range of hot new offerings that Electrolux has. One clear hit is a cordless stick and hand vacuum, called Pronto in the U.S. Available in an array of metallic hues with a rounded, ergonomic design, this is the Cinderella of vacuums. Too attractive to

The Pronto vacuum swept the U.S. and Europe

be locked up in the broom closet, it calls out to be displayed in your kitchen. In Europe, it now commands 50% of the market for stick vacs, a coup for a product with fewer than two years on the market. The Pronto is cleaning up in

the U.S., too. Stacy Silk, a buyer at retail chain Best Buy Co., says it is one of her hottest sellers, even though it retails for around \$100, double the price of comparable models. "The biggest thing is the aesthetics," Silk says. "That gets people to walk over and look."

Straberg, who spent decades running Electrolux operations in the U.S., is crafting these new products even while moving away from many traditional tools of customer research. The company relies less heavily on focus groups, and now prefers to interview people in their homes where they can be videotaped pushing a vacuum or shoving laundry into the washer. "Consumers think they know what they want, but they often have trouble articulating it," says Henrik Otto, senior vice-president for global design, whom Straberg lured away from carmaker Volvo. "But when we watch them, we can ask, 'why do you do that?' We can change the product and solve their problems."

The new approach is starting to yield results. After dropping for two straight years, annual sales rose 8%, to \$16.5 billion, in 2005. Operating income jumped 42% in the fourth quarter, compared with the year before, though it rose by less than 2%, to \$881 million, for the year as a whole. Johan Hjertons-son, director of the consumer innovation

program, says product launches have almost doubled in quantity. And the number of launches that result in outsized unit sales is now running at 50% of all introductions, from around 25% previously. The stock? Up a third in the last year. Catherine would be pleased. ■

—With Michael Arndt in Chicago



BusinessWeek online For a slide show of Electrolux' best-selling appliances and some of its more intriguing prospects, go to www.businessweek.com/extras.



CORE PRODUCT Icahn wants KT&G to sell off other businesses

SOUTH KOREA

AN UNRULY GUEST FROM THE WEST

Icahn's fight at tobacco giant KT&G may spark more activity by foreign investors

BY MOON IHLWAN

YOU MIGHT THINK CARL Icahn has his hands full with the battle over Time Warner Inc. But he's also been busy making a name for himself in Korea. "Corporate Pirate," "Wall Street Naughty Boy," and "Cold Negotiator" are some of the nicer things Korean newspapers have called the U.S. financier lately. Why the vitriol? Icahn and fellow investor Warren G. Lichtenstein now control 7.3% of the shares of KT&G Corp., Korea's former tobacco monopoly, and are demanding changes they hope will boost the stock's value. The country's opinion leaders, meanwhile, apparently find the notion of foreigners calling the shots tough to stomach.

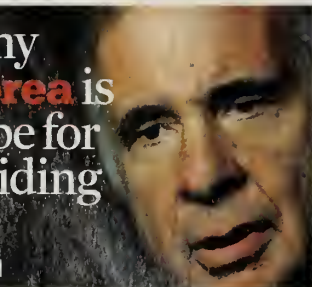
It's a taste they had better get used to. Until a decade ago, outsiders had a hard time penetrating the erstwhile "Hermit Kingdom." But today foreign investors own 42% of the shares on the Seoul bourse, compared with 13%

before the Asian financial meltdown of 1997-98. And at some big companies, foreign ownership is much higher. At KT&G it's 63%. At Korea's largest lender, Kookmin Bank, it's 85.7%; at Posco, the country's top steelmaker, it's 68%; and at Samsung Electronics, it's 54%. All told, 109 foreign investors hold more than 5% of at least one Korean company and have filed papers saying they intend to influence management. "Icahn heralds a new wave of activism by international investors," says Young Chang, head of research at UBS Korea. "Soon such a campaign won't be a novelty."

Other factors may accelerate the trend. At least a dozen Korean blue chips, including KT&G, Posco, and Kookmin, lack a controlling shareholder, making it easier for discontented investors to be heard.

Why Korea is Ripe for Raiding

ICAHN



OWNERSHIP Many companies lack strong controlling shareholder making it easier for smaller investors to influence management

PRICE Korean shares are comparatively cheap, trading at 10.2 times expected '06 earnings, vs. 18.8 in Japan and 16.2 in Hong Kong

TRANSPARENCY The 1997 Asian financial crisis forced Korea Inc. to clean up its act, so accounting statements are now more reliable

CURRENCY The won has risen by 20% against the dollar in the past two years, boosting dollar profits for foreign investors

The Korean won has gained some 20% against the greenback in the past two years, boosting dollar gains for foreign investors. And the market is relatively cheap, trading at just 10.2 times estimated 2006 earnings, compared with 18.8 in Japan, 16.2 in Hong Kong, and 15.7 in India, according to Morgan Stanley.

UNLIKELY TARGET

BY MANY MEASURES, KT&G would seem to be in the kind of distress that normally draws corporate bottom feeders. But Icahn and Lichtenstein, who KT&G controls three-quarters of Korea's cigarette market, and its net profits—\$500 million in 2005—have jumped an average of 14.1% annually in the past four years. Its share price has more than tripled since 2003, thanks partly to shareholder-friendly policies such as doling out half the profits as dividends. And it's often praised for its corporate governance.

Nonetheless, Icahn and Lichtenstein think Chief Executive Kwak Young Kyu could do better. They say he has pressed profits by holding on to factory sites instead of selling the real estate. And they want Kwak to unload non-core assets, such as a convenience store chain and a pharmaceutical unit, and shares in a fast-growing subsidiary that makes drinks and other products from ginseng, an herbal tonic. Icahn and Lichtenstein, head of private investment partnership Steel Partners II, declined comment for this story. At a news conference, Kwak said their demands were "excessive" measures that would hurt long-term profitability.

Now the stage is set for a proxy fight. When Lichtenstein announced on Feb. 1 that he would seek a board seat, KT&G shares the next day climbed 8.9%. Icahn has signed up Goldman Sachs & Co. to help manage the fight. The Korea Center for International Finance, a state-funded research group, says the outcome is tough to predict, with some 30% of shares—largely held by Koreans—likely to back management, and 16% currently lined up behind the challengers. Whoever prevails, it seems a new wave of "corporate pirates" is sure to set sail for Korea.

Data: BusinessWeek, Morgan Stanley

INDIA

SELLING GENERICS USED TO BE SO EASY

Suddenly, drugmakers Dr. Reddy's and Ranbaxy have a host of copycat rivals

BY BRUCE EINHORN
AND MANJEET KRIPALANI

It was supposed to be the Next Big Thing from India: Its pharma companies would do to the drug industry what Bangalore did to software and the back office. And in fact, rival Indian drugmakers Dr. Reddy's Laboratories Ltd. and Ranbaxy Laboratories Ltd. have turned into some of Big Pharma's fiercest competition. The two have plowed huge resources into the generics business, providing U.S. consumers with low-cost versions of brand-name drugs such as Prozac and Augmentin—and sapping profits at the major pharmaceutical companies that once held the patents to those formulas.

But this is not a story of untrammelled triumph for the subcontinent; the big Indian pharma companies are now getting a taste of their own medicine. The success of Dr. Reddy's and Ranbaxy has inspired a wave of copycats. A dozen or so Indian companies now sell generics in the U.S., and Indians today account for \$8 billion of the world's \$48 billion market for generics. "There is a huge gold rush into" the U.S., says G.V. Prasad, chief executive of Dr. Reddy's.

It's getting harder to find the gold, though, as major Western drugmakers dig back. For instance, Ranbaxy recently lost a high-profile battle with Pfizer Inc. over generic rights to the cholesterol drug Lipitor. And Big Pharma companies have started selling their own generic versions of blockbuster drugs once their patents expired. The result has been "pricing pressure that is quite brutal," says Brian W. Beresford, executive vice-chairman at Ranbaxy. A few years ago companies launching a generic of a big-name drug could expect to make about 25% of the original price. "Today it is south of 5%," says Prasad.

That's hitting the two companies

where it hurts. In mid-January, Ranbaxy announced that fourth-quarter profits dropped 56%, to \$15.5 million, largely because of falling prices for U.S. generics. Dr. Reddy's reported a big jump in profits to \$14 million, but that was driven mostly by one-time savings from the sale of a facility in India and other cost-cutting measures. Indian drugmakers "have to be sprinting to stay in the same place," says Vinay Parikh, a fund manager in Bombay.

What to do? Cut deals, for one thing, especially in the U.S. Last year, for instance, India's Sun Pharmaceutical Industries acquired Able Laboratories, a generics maker from New Jersey, and bought an Ohio factory from California-based Valeant Pharmaceuticals International. In December, Bombay's Glenmark Pharmaceuticals announced a deal with InvaGen Pharmaceuticals, a New York producer of generics, to work together to sell seven drugs in the U.S. And on Feb. 1, Dr. Reddy's reached a deal to sell authorized generics of Merck & Co.'s cholesterol drug Zocor and prostate formula Proscar in the U.S.

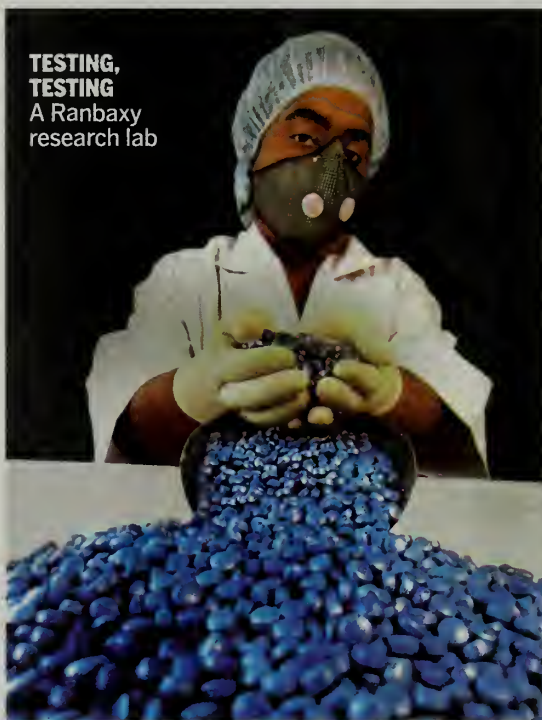
TROUBLE AT HOME

EUROPE BECKONS, TOO. Both Dr. Reddy's and Ranbaxy are bidding to acquire German generics maker Betapharm. On Feb. 10, Aurobindo Pharma, based in the southern Indian city of Hyderabad, announced it was acquiring Milpharm, a British generics maker. And other Indian companies are raising funds for overseas deals.

Even as they explore markets abroad, though, the Indians are facing increased competition at home. India is opening up, and foreign generics makers are eager to take advantage of the low costs that have helped the locals. Israel's Teva Pharmaceutical Industries Ltd., the world's No. 1 maker of generics, is on the prowl. And Teva's biggest rival, Novartis subsidiary Sandoz Inc., has more than 1,000 employees in India working on product development and manufacturing. Big Pharma's enemies, it seems, are facing a big-time brawl of their own. ■

—With Kerry Capell in London

TESTING,
TESTING
A Ranbaxy
research lab



Outward Bound

As generic prices fall, India's drugmakers are looking abroad for growth

RANBAXY Competing with Dr. Reddy's to buy German generics maker Betapharm

DR REDDY'S Bidding for Betapharm; will sell authorized generics of two Merck drugs in the U.S.

WOCKHARDT HOSPITALS Arranging a \$250 million loan to fund U.S. and European acquisitions

SUN PHARMACEUTICAL Last year bought Able Laboratories, a New Jersey-based generics maker

CIPLA In November signed deal with Illinois-based Akorn to sell an anti-infective drug in the U.S.

MATRIX Plans to raise \$200 million in a stock offering, with overseas deals likely to follow



FILL 'ER UP Sasol supplies 28% of South Africa's needs

SOUTH AFRICA

WHAT THE U.S. CAN LEARN FROM SASOL

The company makes liquid fuel from coal, not Mideast oil. And its margins are huge

BY STANLEY REED

SOME 90 MILES SOUTH-east of Johannesburg, the cooling towers and pipes of a giant industrial installation sprawl across five square miles. What happens at Secunda, as the place is known, is of great interest these days. At a time of sky-high oil prices, Sasol Ltd., Secunda's owner, churns out 160,000 barrels of gasoline, diesel fuel, and jet fuel a day, enough to cover 28% of South Africa's needs, without using a single drop of crude oil, imported or otherwise.

Sasol is not a household name, but maybe it should be. President George W. Bush wants to curb America's dependence on Middle East oil. Analysts worry about a future gap between supplies and relentless demand. Yet Sasol, with \$11.2 billion in revenues, is already enjoying huge commercial success in an arena that has eluded U.S. companies—making fuel from coal. It is embarking on a program to brew clean-burning diesel from natural gas. It may even link up with coal producers in the U.S. heartland. "What is

coming out of the U.S. makes us think there is a real business opportunity for us," says Sasol CEO Pat Davies.

No wonder investors have boosted Sasol's New York Stock Exchange-traded shares by almost 60% in a year, to 34. "You have to tip your hat to them," says Bernard J. Picchi of New York's Foresight Research Solutions LLC. "They've been doing [synfuels] longer than anyone else."

Sasol's technology for making gasoline from coal is named Fischer-Tropsch, after the Germans who developed it in the 1920s. The Third Reich used the process—which employs heat, pressure, and catalysts to transform carbon monoxide and hydrogen into fuels—to make diesel during World War II. Similarly, South Africa's apartheid regime employed it to ease the effects of the embargo in the '80s. Sasol has spent decades

refining the technology and now has money-spinner. Assuming oil prices stay in their current range, synfuels alone should earn Sasol \$2 billion in operating profits for the year ending June 30, 2006, says Picchi. The fat profits have prompted some South African policymakers to call for a windfall tax on Sasol, a development that recently affected the stock.

GOING ON THE ROAD

SASOL IS SUPPLEMENTING its home operations with overseas ventures. The first to come online will be gas-to-liquid (GTL) plants in Qatar and Nigeria. GTL plants use a version of the coal-to-liquid technology to make liquid fuels and petrochemicals from natural gas, which Qatar has in abundance. The Qatar plant will eventually produce 34,000 barrels a day of super-clean diesel fuel and other products for Europe. Sasol is also allying its GTL technology with Chevron's exploration and production skills. The two are building a facility at Escravos, Nigeria, and planning another plant in Qatar.

One drawback: cost. Building a GTL plant can cost \$40,000 per daily barrel capacity vs. \$15,000 for a conventional refinery. But by Sasol figures, the company can still make \$30 a barrel if it gets low-cost gas feedstock and crude stays fairly high. Picchi figures Sasol will be getting gas in Qatar and Nigeria at the equivalent of \$5 to \$10 for a barrel of oil. He sees Sasol earning \$350 million a year from those ventures.

Making money out of coal-to-liquids is tougher, since the plants cost more. Nonetheless, coal-rich Pennsylvania has assembled a package of federal and state funding that comes close to the \$625 million estimated price tag of a pilot project.

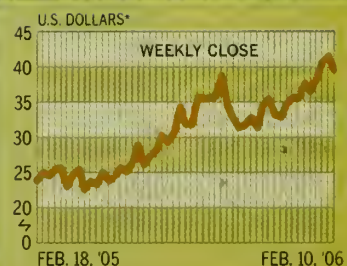
The facility, to make diesel from what coal, would use technology from Royal Dutch Shell and Sasol.

Davies thinks such projects could be viable in the U.S. with oil prices at \$40 a barrel with "the right incentives." Even Sasol would have overcome concern about CO₂ emissions, Davies figures that

the time Sasol invests in the U.S., "processes will meet environmental regulations." The hurdles are high. But Sasol has a technology that every energy-hungry country wants to tap. ■

—With Adam Aston in New York

SASOL SURGES



Data: Bloomberg Financial Markets *U.S. TRADED ADRS

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The Office Chart That Really Counts

Mapping informal relationships at a company is revealing—and useful

BY JENA MCGREGOR

TWO YEARS AGO, KEN Loughridge, an information technology manager living in Cheshire, England, uprooted his family and moved to the other side of the world. His company, engineering and environmental consulting firm MWH Global, was reorganizing its various information technology offices into a single global division, establishing its main service center on New Zealand's more cost-effective shores and promoting Loughridge to manage the company's worldwide network, system, and desktop needs. "By and large, the staff I'd adopted were strangers," he says.

To help adjust to his new surroundings, Loughridge took a map with him. A map of his organization, that is. A few months before, MWH had surveyed its IT employees, asking them which colleagues they consulted most frequently, who they turned to for expertise, and who either boosted or drained their energy levels. Their answers were analyzed in a software program and then plotted as a web of interconnecting nodes and lines representing people and relationships. Looking a little like an airline's hub-and-spoke route maps, the web offered Loughridge a map—a corporate X-ray, in a sense—to how work really got done among his charges. It helped him visualize the invisible, informal connections between people that are missing on a traditional organizational chart.

Loughridge used the map to identify well-connected technical experts he should immediately visit face-to-face. And six months into the job, when a key manager in the Asia region left the company, he referred back to it, reaching out to the departed managers' closest con-

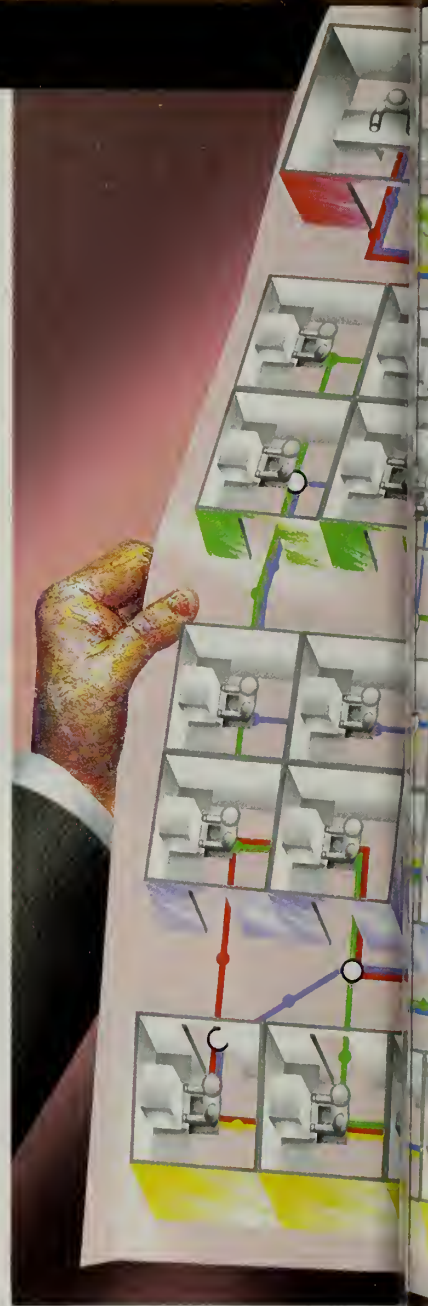
tacts to help minimize the fallout. "It's as if you took the top off an ant hill and could see where there's a hive of activity," he says of the map. "It really helped me understand who the players were."

BIRD'S-EYE VIEW

WHILE NOT BRAND-NEW—independent consultants and researchers at IBM have been mapping informal networks for a number of years—the use of social network analysis as a management tool is accelerating. Given the current emphasis on managing talent, companies are hungry for ways to find and nurture their organizations' most in-the-know employees. And as innovation becomes more critical to corporate survival, the tool lets managers survey the informal interactions between different groups of employees that lead to exciting new ideas. Such a bird's-eye view also exposes the glaring gaps where groups aren't interacting but should be. "Making the collaboration visible makes it much easier to talk about," says Kate Ehrlich, a researcher at IBM who studies collaboration.

Management consultants and academics, along with technological advances, are also driving the trend. Accenture Ltd. and Katzenbach Partners LLP have begun analyzing the informal con-

nections in their clients' organizations during the past year. Boston Consulting Group, meanwhile, is using the approach to map ideas: In November, it launched a proprietary software program that tracks its clients', and in some cases their competitors', patents and research papers. BCG people can chart their internal a-



PLAYBOOK: BEST-PRACTICE IDEAS

Reasons For an X-Ray

A map of social networks can help in these common situations:

INTEGRATING MERGERS & ACQUISITIONS

Social network maps can help identify key players that you don't want to lose and, post-merger, tell whether integration is taking place.

MANAGING CHANGE

Knowing which people to respect of their people communicating new or reorganizations them—can help bring change more effective



Procter & Gamble, Merck, and Lehman Brothers as participants.

One company in that roundtable is Capital One Financial Corp., which began using the maps in October to help maintain links between people with similar jobs after a reorganization along product lines. These online communities for groups such as project managers, credit-risk experts, and even administrative assistants serve as forums for people who don't regularly work together to share best practices. In hopes of drawing more participation, the McLean (Va.) financial services company used the maps to encourage well-connected folks—those who show up as “hubs” on the map—to take formal, central roles on the forums.

While knowledge sharing is one of the most common reasons that companies employ the practice, managers are finding other useful applications. Last year, Solvay, a Belgian pharmaceutical and chemical company, began using maps to help with leadership transitions, or “baton passing,” as Philippe Drouillon, a knowledge management project specialist, calls it. “You have a map that you can provide to successors and say: ‘These are the interactions I have with the people that you should know,’” he says.

FEELING THREATENED

SOLVAY IS ALSO USING maps to spur its innovation efforts. In October it held several “scientific days,” inviting outside university researchers for two days of face-to-face discussions. To ensure that the occasion wasn't just a one-off with little follow-up, Drouillon and his team mapped its scientists' internal and external networks before and after the event to see where research interests overlapped and where potential existed for collaboration. The hope, says Drouillon, is “to increase our innovation impact”

after the event was over. “We wanted to invite connections that could be implemented between [Solvay] scientists, not just outside scientists.”

For all of the benefits, charting informal networks can be disruptive. “Leaders feel pretty threatened by this,” says Katzenbach principal Zia Khan, speaking of people who hold high perches on the organization chart but are more isolated on the informal map. When using social network analysis, suggests University of Virginia's Cross, it's important to communicate to employees that more connections aren't necessarily better: It's O.K. for some people, such as those who spend a lot of time with customers or have expertise in niche areas, to show up on the periphery of the web.

Maps can also highlight which employees might be too connected and therefore a potential bottleneck.

Confidentiality is also a touchy issue. A map that reveals who is well-connected and who is not can be destructive if it is shared too widely. “I know who I named, but when I look at the map, I might see [that person] didn't name me back,” says Tracy Cox, director of enterprise integration at aerospace and defense contractor Raytheon Co. Now, says Cox, who does network analyses for the company's seven businesses, that hypothetical employee “knows that he is not valuable to his boss. And not only does he know it, but 50 of his closest friends know it, too.”

Instead, the maps Cox shares with the groups that he works with are carefully coded; employees are described only by generic characteristics such as job titles. Cox provides a separate list of the group's most connected people to everyone. Individuals can ask to see their portion of the maps and are offered one-on-one coaching to interpret them, but their supervisors aren't allowed to see them.

Are the maps still helpful if individuals' locations aren't revealed? Cross says yes. In 95% of the companies that he works with, only the very top two or three managers actually see a complete map with names. Everyone else can see where silos are occurring, where acquired teams aren't integrating, or where collaboration could be happening but isn't yet. “Putting that diagram in front of everyone is powerful because it's not just the boss who's walking around saying: ‘We're not collaborating,’” Cross says. “It's what everyone is saying.” ■

Those with high perches could be shown as isolated on a social chart

SPARKING INNOVATION

sparked when outside their traditional networks. Seeing where collaboration are can help managers opportunities for growth.

SPOTTING TALENT

Some of the best respected employees aren't visible on the traditional organizational chart but are exposed by a network map. Tap them for key projects but know that formalizing their status could harm peers' trust.

PLANNING FOR SUCCESSION

Social network analysis can help assure managers that potential successors are trusted by the organization and shine a spotlight on key experts whose departure would be disruptive.

Who Says Money Can't Buy Hipness?

Small sites are fetching lofty prices as Big Media chases their young followers

BY JESSI HEMPEL AND TOM LOWRY

DAILYCANDY, THE POPULAR Web site of fashion, beauty, and lifestyle trends, was founded in 2000 at the height of the last Internet bubble. Now it looks as if DailyCandy Inc. could wind up heralding the arrival of Bubble 2.0. A *Wall Street Journal* report on Feb. 15 that former AOL Time Warner Inc. executive Robert W. Pittman, whose private investment firm Pilot Group LP is DailyCandy's majority owner, was putting the site on the block fueled speculation that it could garner offers of \$100 million or more.

DailyCandy, which breathlessly describes itself as "the ultimate insider guide to what's new, hot, and undiscovered," is the brainchild of Dany Levy, a 33-year-old onetime *New York* magazine editor. It has 11 daily city editions and a vibrant e-mail newsletter, and its trend-setting editors have steady gigs on the *Today* show to talk about the next hot sneaker or spa service. DailyCandy's Levy declined to comment; Pittman couldn't be reached.

Buzz machines like DailyCandy have become all the rage among corporate buyers looking to connect with the hordes of young people living and spending online. Because the sites always seem a few paces ahead of the action, venture capitalists are loosening purse strings, while larger outfits are looking to buy up existing sites rather than trying to create their own from scratch.

When someone like News Corp. Chairman Rupert Murdoch sets aside \$1 billion for Web buys, it's clear that prices are des-



tinued to inflate. In July, Murdoch plunked down \$580 million to buy MySpace.com, the social networking leader. Because users of sites such as MySpace are largely under 25, investors and Big Media companies see them as a direct route to a highly coveted but elusive demographic. "The risk, of course, with these sites is if they turn out to be fads" instead of something that's sustainable, says Aryeh Bourkoff, a UBS analyst.

For now, at least, Levy and other Web entrepreneurs are in a seriously enviable spot. Take David Cook and his sister Catherine. A venture capital firm, a tech startup, and a small public company have all made offers for myYearbook.com, the social networking site the siblings started last April (page 20). Cook says one suitor is offering big bucks—into eight figures—while another promises creative control.

The third contender has an office near the Cooks' Skillman (N.J.) home—a big plus. After all, says 17-year-old David, "we're high school."

The Cooks got their first investment of \$250,000, from their 27-year-old brother Geoff, who'd founded and sold his own Web business. They outsourced design programmers in India and launched the site on rented servers. At high school they offered free T-shirts or thongs to students who signed up five friends. After traffic jumped twelvefold in November, myYearbook.com made it onto the top-ranking site Alexa.com's list of movers and shakers, and buyout offers rolled in.

In this market, Web site sellers have a lot of competition. The Cooks' rivals include Jay Gould, 26, who launched the video-sharing sites in the fall of 2004 and sold them in December 2005. Users of the sites, MySicVideocodes.com and Yashi.com, can search databases of videos and attach them to everything from e-mails to MySpace profiles. Gould outsourced the site design and set up shop in his grandfather's Bayville (N.J.) basement. In December the sites attracted 3.3 million unique views, according to comScore Media Metrix. Gould sold them to New York media company Bolt Inc. that month in a mostly equity deal that makes him a partner in the company.

CANDY MAN Pittman's Pilot Group is expected to see offers of \$100 million or more for the site.

Two other twentysomething online entrepreneurs, Greg Tseng and John Schleier-Smith, also attracted money quickly for their teen portal Tagged.com. But Tseng and Schleier-Smith wanted venture capital for the 35-person company. Their ambitions are nothing if grand: "We want to build...a Teen hoo! or the next MTV," says Tseng. They didn't have to wait long for their growth capital. The site launched in mid-2004 with about \$1 million from their savings. Traffic hit 1.6 million unique page views in December. The same month the company reeled in \$7 million from Mayfield Fund of Menlo Park, Calif.

Those thinking of starting similar sites better move fast. Buyers may find that loyalty can be fleeting. But that isn't likely to discourage the frenzied internet. Meanwhile, a new generation of dot-com millionaires, some not old enough to celebrate at the local bar, is being born.

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COVER STORY





Going Private

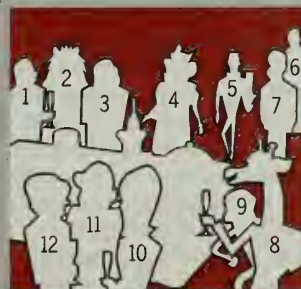
Hotshot managers are fleeing public companies for the money, freedom, and glamour of private equity

BY EMILY THORNTON

ASK J. CREW GROUP INC. CHAIRMAN AND CHIEF executive Millard S. "Mickey" Drexler what it's like to run a public company, and he curls his fingers into the shape of a pistol. "You have a gun to your head," he says. Drexler knows of what he speaks. He spent four years running AnnTaylor Stores Corp. and seven years as CEO of Gap Inc., where he gained his reputation as a turnaround artist before being ousted in 2002.

Drexler, 61, could be enjoying an uncommonly comfortable retirement right now. Instead he's working harder than ever, trying to revitalize the fashionable clothier. He loves the challenge of transforming companies, and retailing is in his blood. But the best part about the new gig is that he doesn't have to answer to public shareholders every step of the way. Drexler works for Texas Pacific Group, a \$22 billion Fort Worth pri-

1. Jack Welch, Clayton, Dubilier & Rice
2. MGM
3. Lou Gerstner, Carlyle Group
4. Burger King
5. Unemployed actor
6. Mickey Drexler, runs J. Crew Group, majority owned by Texas Pacific Group
7. Jacques Nasser, One Equity Partners
8. Toys 'R' Us
9. Houghton Mifflin
10. Ann Jackson, CEO of WRC Media, owned by Ripplewood Holdings



11. Dunkin' Brands
12. Paul O'Neill, Blackstone Group

Data: BusinessWeek, companies

ROBERT RISKO

“In a private setting, you eliminate the dysfunctional short-term focus on quarterly results.”

LOU GERSTNER,
Chairman of Carlyle Group



vate-equity firm. It hired Drexler in 2003 and supported him through a long overhaul that included chucking a year's worth of J. Crew skirts, pants, and sweaters. Now, he says, he has "an ownership that truly cares about long-term shareholder value," in stark contrast to public investors who obsess over quarterly earnings.

Luminaries like Drexler are bolting in droves for private equity, the freewheeling world where investors buy slumping companies and try to turn them around to sell or take public, risking billions of dollars in the process. Former General Electric CEO Jack F. Welch now evaluates investments at Clayton, Dubilier & Rice Inc., a \$6 billion New York firm. (Welch and his wife, Suzy, write a column for *BusinessWeek*.) Onetime IBM chief Louis V. Gerstner Jr., who has alternated between private and public companies for two decades, is back in the private sphere as chairman of the Carlyle Group, a Washington (D.C.) firm with \$35 billion in committed capital. Former Ford Motor Co. CEO Jacques Nasser is a partner at the \$5 billion One Equity Partners, an affiliate of JPMorgan Chase & Co. Former Continental Airlines Inc. President Greg Brenneman fixed up Burger King for private-equity firms and is about to take it public. Viacom Inc.'s former chief financial officer, Richard J. Bressler, works for Thomas H. Lee Partners LP, a Boston fund with \$12 billion of committed capital. Gerald Storch, former vice-chairman of Target Corp., has been tapped to run Toys 'R' Us for private-equity owners Bain Capital (\$27 billion) of Boston and Kohlberg Kravis Roberts & Co. (\$11.5 billion) of New York (along with Vornado Realty Trust). And on and on.

It isn't only CEOs who are making the move to private-equity firms. Fast-rising midcareer folks are lining up, too. "The interest has really gone through the roof," says Anthony Lando,

partner and director of Benchmark Search Group, a financial executive recruiter in Stamford, Conn. Newly minted MBAs are joining them. Back in the 1980s most B-school students wanted to be investment bankers. In the 1990s it was tech-related venture capital and dot-coms. Now, private equity is hot.

Long-Term Luxury

THE ATTRACTIONS ARE TWOFOLD: money and freedom. The pay can be outrageously good even at the entry levels; for CEOs it can be spectacular. The flexibility is alluring, too. In private equity there's less annoyance from the Sarbanes-Oxley Act, controversial regulations passed in 2002 to police publicly held companies. And many private CEOs will avoid the Securities Exchange Commission's new proposal that would require highest-paid executives at public companies to disclose their compensation in excruciating detail. (These rules and proposals still apply to companies that issue registered public debt.)

Regulatory issues aside, the fundamental nature of private-equity work is different. CEOs have a freer hand to do the tough but necessary things to repair companies for the long term, with less focus on quarterly results and placating public shareholders and more on meeting the strategic yardsticks of a multiyear turnaround effort. Drexler, for one, says he never could have scrapped so much

**Money Is Flooding
Private Equity Firms**

**...Fueling
Big Deals**



“There’s no clear road map of what to do; you really feel very independent. That is good but challenging.”

ANN JACKSON,
CEO of WRC Media

ventory at a public company focused on short-term results. Going private dodges another nuisance: activist hedge funds. You’re seeing more instances of hedge funds taking major stakes in companies to cause a sale or major restructuring of a business,” says Daniel S. O’Connell, CEO and founder of 18-year-old Vestar Capital Partners, with \$7 billion of committed capital. “That will lead to more [companies] going private.” Private-equity CEOs, in other words, don’t feel like the gun is pointed at their heads at all times. That allows them to “take it easy” that public shareholders won’t,” says Donald J. Gogel, CEO of Clayton Dubilier. For example, since Bear Stearns Merchant Banking bought what has become New York & Co. from The Limited in November, 2002, it has refurbished or opened 260 stores, more than half the chain’s outlets. A public company would have found it more difficult to make so large an investment in a languishing, minor business. “Managers now understand that involvement in the private-equity world is potentially more interesting, more lucrative, and less of a hassle,” says Texas Pacific Group founding partner James “Jim” Coulter.

The Carlyle Group’s Gerstner says he’s thrilled he went private. “The private-equity industry allows an organization, or a part of [one], that is operating at a subpar level to be spun off, refinanced, reenergized, refocused,” he says. “It’s a very significant part of what is going on in the world today.”

For Ann W. Jackson, a 23-year veteran at Time Inc., the appeal of private companies is their nimbleness. She joined Ripplewood Holdings LLC, a \$10 billion New York firm, last April, and in November became the CEO of educational publisher WRC Media Inc. Jackson and her three division presidents review their progress each week to see if they’re slipping off their targets, and move quickly when necessary. “It’s a 30-second decision,” says Jackson, who has limited her executive team to six to keep down bureaucracy. At public companies, Jackson says, rigid hierarchies prevent such decisive moves.

Vivek Paul, vice-chairman of Indian software maker Wipro Ltd. until September, 2005, likes the variety of private equity. He’s now part of a team at Texas Pacific investing in different sorts of technology and life sciences companies. “I felt I was a frog in a well at Wipro,” says Paul. “Now I have a panoramic view of business across various industries and companies and countries.” Former Paine Webber Group Inc. CEO Donald B. Marron enjoys running his own \$2 billion private-equity firm Lightyear Capital Inc., which invests in businesses providing finan-

	2002	2003	2004	2005
FLUWS WIDE*	\$17	24	42	174
	2002	2005	2004	2005
RATE M&A*	\$130	152	259	370

Data: Thomson Financial; Buyouts magazine, a Thomson publication

“[We have]
an ownership
that truly cares
about long-term
shareholder value.”

MICKEY DREXLER,
CEO of J. Crew Group



cial services ranging from crop insurance to college funding.

Not that private equals perfect. The business is fraught with risk, and fund partners, with hundreds of millions of dollars at stake, can be stern taskmasters. There are also legitimate reasons for public shareholders to be wary of the privatization trend. And for all the faults of the public life, there are still plenty of CEOs who are perfectly happy to remain in the fishbowl.

To a large extent the private-equity phenomenon is cyclical. Another bull market for stocks could slow or even reverse the movement. Wave millions of in-the-money stock options in front of a CEO and suddenly Sarbanes-Oxley and the other headaches of public companies will seem less painful. Sooner or later, the private-equity market will cool off (page 58).

But for now it is sizzling. The industry controls \$800 billion in capital, estimates researcher Thomson Venture Economics, more than the \$756 billion that Americans spent building new homes and renovating existing ones last year. Fifteen years ago there were only a handful of firms managing at least \$1 billion; now there are at least 260. Just three firms—Carlyle, KKR, and New York-based Blackstone Group—preside over businesses that employ 907,000 people. In 2005, estimates *Buyouts* magazine, \$174 billion in new money flowed into U.S.-based private-equity firms (table, page 54-55). Who's investing? Well-heeled institutions such as pension funds looking for higher returns than the single digits delivered by the stock market the past few years.

Flush with cash, firms are buying bigger-name companies and enticing higher-profile public executives to come on board. Private-equity funds have scooped up Dunkin' Brands, Neiman Marcus, Metro-Goldwyn-Mayer, and Toys 'R Us name a few purchases since the start of 2005.

Hear that noise? It's the giant sucking sound of capital talent exiting the public realm.

The Money Beckons

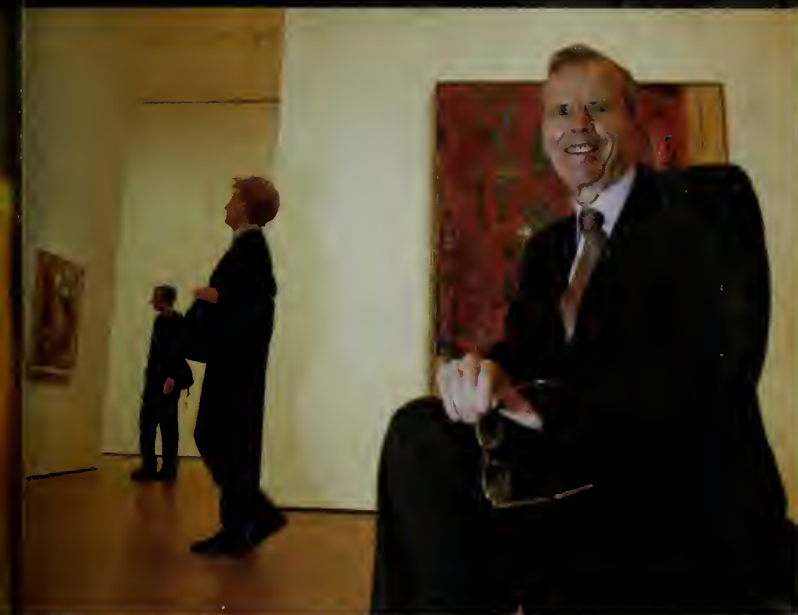
NO ONE KNOWS THE FULL extent of the privatization wave. Firms, and the companies they run, are intensely secretive.

But word of the massive amounts of money being made is spreading. Here's how the millions pile up. Partners typically take 1.5% or so off the top as a management fee each year. A four to six partners of a \$1 billion fund might split \$5 million every year among themselves, after paying out, say, \$10 million for staff and other costs, estimates Brian Korb, a partner at Glocap Search, a New York executive recruiting firm.

Partners also get a share of profits, usually 20%, when a company is sold or taken public. Say the value of the company owned by a private-equity firm doubles, to \$2 billion, when they sell them. The partners would split \$200 million of the \$1 billion increase. (The fund's investors would get the other \$1 billion.) And any money that partners co-invested with shareholders would also double. To top it off, their investment bo

rant

rave



“You’re out buying other companies, so you can range as far afield as you like.”

DON MARRON,
CEO of Lightyear Capital

ould be taxed at 15% as long-term capital gains (assuming the investment was held at least a year), vs. the 35% that public company CEOs must shell out for their ordinary income.

Not all CEOs are partners, but they don't need to be to earn huge sums. When private-equity firms recruit executives to run companies for them, they typically offer them small cash salaries but also a chance to invest their own money for a stake in the company, sometimes as much as 20%. This is highly risky for the CEO, of course. But it's proving, for now, to be a better incentive than the stock options grants available at public companies, which haven't paid off in the sideways stock market of the past few years.

Consider Drexler. He earns a modest annual salary of \$100,000, but he was allowed to co-invest \$10 million with Texas Pacific, and now owns a stunning 22% stake in J. Crew. That could turn into as much as a \$300 million payday for Drexler if the company goes public; the more he succeeds in running the company around, the more money he will make. Drexler declined to comment on the prospect of an IPO, but market watchers expect one this year.)

It's difficult for public companies to compete with that. "When we recruit a CEO to a public company, we can't offer them [even] 5% of the company," says Dennis Carey, vice-chairman of executive recruiting firm Spencer Stuart.

Buyout firms can afford to be generous. Most big ones boast annual returns in excess of 20%, vs. the average 5% return de-

livered last year by companies in the S&P 500. "If an executive makes his numbers, and we get a 25% to 30% return, he should be paid a lot," says Daniel F. Akerson, who ran wireless outfit Nextel Communications Inc. as well as telecom and broadband services firm XO Communications Inc. before joining Carlyle to co-head the firm's U.S. buyout group in 2003.

Private equity is changing the traditional career cycle for many public company executives. CEOs are no longer content to grind out their last few years running public companies or sitting on their boards. Instead, they're joining private-equity firms as partners to review companies' strategies and to hunt for deals. Or they're heading the companies in firms' portfolios. Or both, as in the case of Jacques Nasser, who at one point was simultaneously chairman of Polaroid Corp. and partner at owner One Equity. "Private equity is becoming a new life-stage for CEOs," says Jeffrey A. Sonnenfeld, professor of management at Yale University. "It's something we have never seen before."

Some executives who fulfill their private-equity mission by taking a company public again are looking to return to the private life. "If you ran a buyout and the exit was to go public, you might stay for a while," says Lawrence Schloss, who ran Credit Suisse First Boston's private-equity business before starting a firm called Diamond Castle Holdings LLC, based in New York, last year. "But hopefully you'd get out, and do the cycle again." Two of Schloss's six partners are former CEOs.

Midcareer executives see private-equity firms as the new fast

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track to running their own shops someday. Jackson says the choice to work for a private-equity firm for the second half of her career was obvious. "I love being the CEO," she says.

Business school students, meanwhile, are angling to get on the partner track. At the University of Chicago, says Julie Morton, associate dean of MBA career services, résumé writing courses for private-equity candidates are oversubscribed. Stanford University is seeing more interest. More 2005 Stanford MBA grads went into private equity than any other area except consulting and consumer products and services.

These students, not yet wary of the public life, are chasing the huge dollars in private equity. The median annual compensation for a 2005 Harvard Business School grad who went to work for a private-equity firm was \$174,500, compared with \$135,000 for the rest of the class. Last year's Stanford grads did better, with median total compensation of \$232,000, compared with \$140,000 for the class. Some private-equity funds pay as much as \$300,000 to fresh MBAs.

Michael A. Barzyk is a second-year MBA student at Chicago. He worked for a private-equity firm for three years before grad school and saw his two years on campus as a way to polish his skills. The Chicago native took an operations course to get a

better handle on management, and spent this past summer working at Sandbox Industries, an incubator. While peers were recently attending "bank week" in New York and doing on-campus interviews with consulting firms, Barzyk was working his contacts, calling on friends, trying to get wind of an opening in a suitable buyout shop. These firms don't recruit on campus so it's up to candidates to hunt up their opportunities.

No Looking Back

AN AWFUL LOT OF HIGH-PROFILE converts say they'll never go back to a public company. Gerstner, 63, says he doesn't miss running one "for a second" (page 62).

That's especially telling because Gerstner worked for buyout firm before, and things didn't exactly end well. In 1989, KKR tapped Gerstner, then president of American Express Co., to run RJR Nabisco. He says he came to realize that KKR had paid too much for the company and couldn't reach its expected returns. When he got the feeling in 1993 that KKR was trying to pull out of RJR, he says, he left to run IBM. (KKR declined to comment.)

With baggage like that, working for a private-equity firm

Buyout Mania's Mountain of Debt

Is there a bubble brewing in the buyout business?

With investors and executives flocking to private equity, it's not just the money pouring into leveraged buyouts that's soaring, or the returns funds are pulling out. Deal prices and leverage are skyrocketing, too. And that has even some seasoned private-equity executives starting to worry that funds are overpaying on deals and loading companies up with too much debt, sowing the seeds of a big rise in defaults. "If this were emerging-market debt, at these numbers no one would touch it," says one fund manager.

Consider some recent deals. To beat out Carl Icahn for luxury chain Fairmont Hotels & Resorts Inc., Los Angeles investment firm Colony Capital LLC and Saudi Prince Alwaleed bin Talal's Kingdom Hotels International agreed in late January to pay \$3.3 billion and assume an additional \$500 million in debt—roughly 21 times earnings before income taxes, depreciation, and amortization (EBITDA) in 2004. Meanwhile, earlier in the month, a group of buyout firms paid 12.8 times EBITDA for Dunkin' Brands Inc., well over the 7 to 8 times typically paid in the restaurant industry. Marvels Tom Marshella, a managing director in leveraged finance for credit-ratings agency Moody's

Corp.: "Those are just extraordinary multiples."

Leverage has also ticked up sharply. In the average deal from 2000 through 2002, companies took on debt equal to four times EBITDA. By the end of 2005 that number had crept up to over 5.6, according to Standard & Poor's LCD unit, which tracks the leveraged loan market. "There's a massive amount of liquidity available, and right now lenders are not being conservative about holding the line," says LCD director Chris Donnelly.

So far they haven't had to worry. Junk-

bond defaults, at just 1.9% in 2005, remain well below the long-term average of around 5%, according to Moody's. Buyout executives say the higher prices and debt levels are easily supported by the faster growth and stronger earnings they achieve. "If we execute against our plans, we improve operations and generate a lot of free cash flow that can go to pay down debt," says Scott M. Sperling, co-president of Thomas H. Lee Partners LP. At Dunkin', for example, greater expansion of the fast-growing coffee and donut chain beyond its Northeast base is planned, while Colony Capital expects big gains in cash flow at Fairmont thanks to recent renovations. A spokesman also adds that the deal is cheap judged by the price paid per room rather than EBITDA multiples.

The question is, what will happen if the economy slows, interest rates climb sharply, or buyout firms stumble in boosting growth or cutting costs? "Some of these deals are priced to perfection," says Michael H. Anderson, U.S. high-yield strategist for Lehman Brothers Inc. "They'll need a strong economy, and management will have to execute perfectly to survive."

If they don't, this buyout boom could go bust, leaving a pile of junk-rated companies, defaulted debt, and lost equity in its wake. That's likely to remain a while off, probably no sooner than 2008, says Martin Fridson, CEO of high-yield bond-market strategist FridsonVision LLC. But with credit quality sharply deteriorating, he expects default rates to climb back to peak levels. The good times, in other words, won't last forever.

—By Jane Sasseen, with David Henry, in New York

Deals Get Pricier



NOTE: FOR PRIVATE EQUITY PURCHASES OF COMPANIES WITH EBITDA OF MORE THAN \$50 MILLION; EXCLUDES MEDIA, TELECOM, ENERGY, AND UTILITY DEALS
Data: Standard & Poor's LCD unit

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“I don’t know if it’s because I have a little bit of ADD. But I don’t get bored in private equity.”

MICHAEL BARZYK,

Second-year MBA student at the University of Chicago

seemed highly unlikely when Gerstner retired from IBM in 2002. His plan was to help fix public schools, advance cancer research, and sit on a few public company boards. Then the phone started ringing. “I got calls from seven private-equity firms,” he recalls.

Gerstner added Carlyle to his list of commitments in 2003 because he thought the private-equity business was changing dramatically. Carlyle’s three founders convinced him they were “serious about making [Carlyle] a meaningful entity,” Gerstner says.

These days, Gerstner is Carlyle’s operational voice on investment decisions. “It’s very easy [for someone evaluating a deal] to say, ‘The margins are going to go from 14% to 18%, and we’re all going to make money,’” he says. “Well, who is going to get the margins up? How is that going to happen?... I get a little antsy when I don’t learn a lot about the management group that’s going to run [the company] from the first 10 pages of a report.” Gerstner also heads a committee that’s responsible for ensuring that Carlyle will last beyond its founders.

George W. Tamke isn’t going back to a public company, either. “You couldn’t write a big enough check,” says Tamke, 58, who was a co-CEO of Emerson Electric Co. until 2000 and became a partner at Clayton Dubilier that same year. Tamke was chairman of copy chain Kinko’s from 2001 to 2004. Now he’s chairman of water supply company Culligan International Co. and the rental car company Hertz Corp. And he’s relishing every moment.

Reason to Worry

THE PRIVATIZATION TREND has made scholars and recruiters take notice. Brain drains are never easy on the parties losing the talent. Some business thinkers, like management professor Michael Useem at the University of Pennsylvania’s Wharton School, see the exodus as a sign that the ascent of widely held companies over the past century might be cresting. With capital in fewer hands, there are fewer checks and balances coming from other stakeholders on how that capital is deployed.

Another drawback: Private companies’ financial results are

shrouded in secrecy, with few outside observers able to question the numbers. That’s why regulators restrict private equity to wealthy investors. “It’s definitely *caveat emptor*,” says Nell Minow, co-founder of the Corporate Library, a corporate governance research firm. “They’d better kick the tires carefully.”

What’s more, the mechanics of a typical private-equity turnaround don’t always favor public shareholders. When buyout firms acquire companies, they often load them up with debt quickly to recoup their investment. For example, within 14 months of buying Warner Music Group from Time Warner Inc. for \$2.6 billion in March, 2004, a group of four private-equity firms led by Thomas H. Lee had borrowed an additional \$700 million in debt and extracted \$1.4 billion in dividends and capital repayment

more than recouping their \$1 billion investment. Lee co-president Scott M. Sperling says Warner’s cash flow improved enough after the buyout to support the debt, pay the dividends and fund the company’s growth.

When private-equity firms bring their companies public again the capital structures of some are shaky. Their governance could be compromised as well. “Most of the time when these things go public... private-equity firms want to get the hell out of there,” says Jay W. Lorsch, a professor of corporate governance at Harvard Business School. “They want to monetize their investment and get their guys off the board, because they don’t want to be caught in a conflict of interest.”

But private-equity firms are also doing things that are decidedly positive for the financial system. As they pay large sums for companies, they’ve come to realize that they need better managers to turn those companies around and make the investments pay off. At this stage, the easy deals have already been done. And so, more than ever, the financial whizzes are wooing top operations executives. Texas Pacific now has 16 operating partners, up from two a decade ago. A third of KKR’s senior executives have an operational background, up from

Private vs. Public

What Was He Thinking?: Edward J. Zander on leaving private equity firm Silver Lake Partners to become CEO of Motorola.

The Company He Keeps: Dunkin’ Brands CEO Jon L. Luther on why he prefers to work for buyout firms in an online video view.

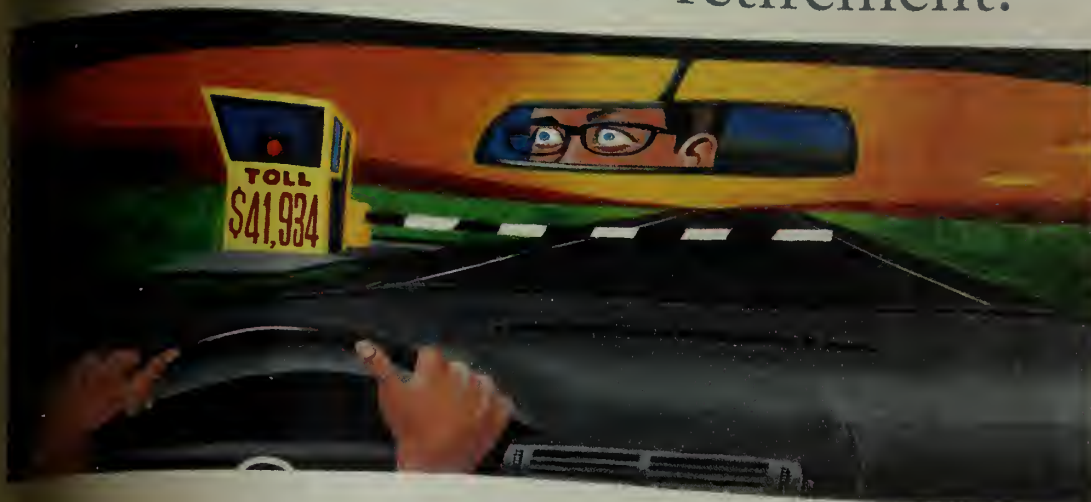
Stuart Weitzman’s Private Reasons: Rather than take his company public, the shoe impresario sold a minority stake to Bear Stearns Merchant Banking—and it wasn’t for the money.

The Story Behind the Story: For a podcast interview with Associate Editor Emily Thornton by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

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It's surprising what most investors don't know
about the road to retirement.



When most investors start out on the road to retirement, the only thing they can see is where they want to end up. Yet, what they should really be watching is how much they're being charged to make the trip. Because when it comes to fees and expenses, the little things can really add up.

For example, take a hypothetical fund with an expense ratio of 1.3 percent versus one with an expense ratio of just 0.3 percent. Applied to a rollover investment of \$100,000, returning 8% before expenses and compounded over 15 years, the difference adds up to \$41,934. That's a hefty toll to pay when the goal is to retire.

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none 10 years ago. "We've added more people at a senior level with an operational orientation to balance [the investment professionals]," says Marc Lipschultz, a KKR partner.

As a result, the companies being brought public again are operationally stronger, leaner, and better, even if they do carry debt. This is a positive development after the go-go 1990s. "We had a period in which companies went public entirely too quickly," says Minow. "Some of them never should have."

Healthier public companies are good for shareholders, obviously. "I'm fairly optimistic about how private-equity-backed deals will do from an investor's point of view," says IPO market expert Jay R. Ritter, Cordell Professor of Finance at the University of Florida. He notes that private-equity-backed IPOs are generally mature, sound companies with annual sales of more

than \$50 million. "Historically, IPOs for companies with at least \$50 million in sales meet or beat the benchmarks," he says.

For better and for worse, the private-equity boom still has plenty of life. Even if the cycle turns and public companies get hot again, private equity's true believers won't go back. CEOs say the freedom to run their companies as they see fit is exhilarating. Private equity is simply more glamorous than public CEO-dom, says recruiter Stephen R. Bochner at Sextant Search Partners LLC in New York. "It's the difference between driving a speedboat and driving an ocean liner," he says. "When you want to turn a speedboat, you turn the wheel. For an ocean liner, you have to plan two days ahead." ■

—With Nanette Byrnes and David Henry in New York and Manjeet Kripalani in Bombay

Glad to Be Out of The Quarterly Grind

When Lou Gerstner left IBM in 2002, working for a private-equity firm was not even remotely on his mind. Now he is chairman of the Carlyle Group. Gerstner recently explained his decision to Associate Editor Emily Thornton.

You worked for Kohlberg, Kravis & Roberts in the '80s. From your point of view, how has the private-equity industry changed?

In the '80s it was a smaller business. A few firms. A few deals. And the fees charged in the '80s almost precluded the necessity of major returns to investors. Today the requirement that you produce operational improvements in companies is a lot [tougher]. It has evolved to the point where your ability to raise new money and your ability to generate a substantial fee come from producing positive operating benefits from the companies you run. [Operational improvements have] become more important than [they were] before.

What's driving private equity today?

The predominant and most important economic activity today is restructuring. Excess capacity has been growing in almost every industry. It's why we don't see any pricing power [anywhere] in the world. Companies are having to restructure, and they're having to get more competitive. They can't just do what they did before. The second most important factor is the impact of information and networking technology. Networking technology is fundamentally altering almost every industry. So the

combination of excess capacity and new technology enables people to create a competitive advantage where they couldn't before. That's driving the restructuring of enterprises around the world.

In your view, is it easier to fix a private company than a public one?

In theory, no. If you've got a really good CEO with strong backing from his or her board, you should be able to go to your shareholders and say: "Look, we're going to go through some tough years. The industry has changed. The competitive environment has changed. We're going to go and fundamentally change this company." That's what I had to do in 1993. I had no choice. We went through a substantial transformation at IBM in a public environment.

In a private setting, you eliminate the dysfunctional short-term focus on quarterly results that dominates the market today. I think there are a lot of executives who are frustrated by the extraordinarily short-term nature of measuring the performance of public companies. I'm amazed to see that some company made 65¢ a share over a 90-day period, and some collection of people thought it should have made 66¢. And it loses \$1 billion in market cap. There's something wrong. And I'm sure that's frustrating. The benefit of being a private company is that you have a longer time frame, and you have a direct alignment of the shareholders with the management to fix the company, to build value over time, and be patient with the changes. There's a big difference between

being tolerant of poor performance and being intolerant of 90-day numbers without an awareness that maybe [the executives] were investing over that period and doing the right thing.

Is there anything to be done?

We have a great deal of attention by regulators to protect small investors. But I don't see a lot of attention being paid to finding a way to have large investors benefit from [focusing on the] long term. I propose that we should tax gains differently for long-term investors than for short-term investors. Until we figure out a way to get [large investors in public companies] to deal with long-term performance, then all of the other things we're doing will not change the preoccupation with short-term results.

When we [at Carlyle] decide to buy a company, we lay out a five-year plan. We sit down quarterly and review all of the companies in the portfolio. But we're not reviewing that quarter's results. We're looking at it against the long-term plan. We don't have to deal with a change in the valuation of our investment because in one 90-day period something happened.

Is there a big difference between the culture of a private-equity firm like Carlyle and a public company?

When I was running a company and one of my divisions was looking to invest hundreds of millions or billions of dollars, we had a very tough-minded approach to when documentation had to be provided. We don't work that way at Carlyle. Sometimes I get an investment document four days in advance. Sometimes someone sends me a heads-up memo two weeks in advance. And sometimes I get [an investment] document the day before.

Do you miss running a public company?
Not at all.



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SPECIAL REPORT

**"I'm not
interested in
being a custodian
over a privileged
place"**

**-Amherst College President
Anthony Marx**



Campus Revolutionary

BY WILLIAM C. SYMONDS

ANTHONY W. MARX HAD NEVER even thought of being a college president. "I was minding my own business" as a Columbia University political science professor in 2002, he says, when a friend who was an Amherst College alum put Marx's name in the hopper to be president of the Massachusetts liberal arts institution. Sure, Marx was flattered, but he also felt underqualified. A career academic, his most important administrative experience

had come before graduate school, when he helped found a college in South Africa to educate blacks deprived by apartheid. "That is very nice," he wrote back to his friend. But I've never been a chairman, a dean, or a provost, and besides, I didn't go to Amherst."

Amherst's search committee felt the same way and tossed his file into the reject pile. But after grilling many top college honchos, a student member remembered Marx and suggested that the group give him a second look.

When Marx finally met the committee, he made an impassioned appeal.

Elite U.S. colleges such as Amherst, he said, are perpetuating deep inequalities in American society. They equate success with serving the privileged elite and have largely abandoned talented youth from poor families, he charged. This deepens the country's growing class divisions and exacerbates the long-term decline in economic and social mobility. Feeling he had nothing to lose since he hadn't sought the job, Marx exhorted the trustees to tackle the problem head-on. "I'm not interested in being a custodian over a privileged place," he remembers telling the gathering of wealthy alums and academic stars that day.

As it turned out, Marx's radical message was just what Amherst trustees wanted to hear. Over the past two decades the

college had committed to increasing minorities to a third of the 1,650-student campus, up from 13% in 1985. But while this brought in more low-income students, Amherst remains an incubator of the elite. More than half its students come from families prosperous enough to pay the full \$42,000 annual tab out of their own pockets. Many shell out thousands more for cars, meals out, and other extras. (One student showed up recently with two BMWs—one a convertible for sunny days.) "We were blown away" by Marx's passion and commitment, recalls Jide Zeitlin, a partner at Goldman, Sachs & Co. who has since become chair of Amherst's board.

Since Marx, now 46, took over in 2003 as Amherst's youngest president ever, he has waged a ceaseless crusade to make the college a leader in welcoming more lower-income students. It's a formidable goal considering how programmed the place is to seek out the best and the brightest: A record 6,300 students applied for just 431 spots in last fall's entering class. Now, Marx is challenging everything from an admissions process tilted toward affluent students to social customs that divide rich and poor students on campus. Essentially, he has set in motion a new affirmative action initiative, this time based on class rather than race.

Marx began making his case soon after he showed up at Amherst's clublike campus, with its rolling lawns and acres of tennis courts. Realizing that a college president is no ship captain who can change course by barking commands, he set out to woo students, administrators, faculty, trustees, and alumni.

One volatile issue he faced was the potential for a backlash from affluent parents worried that their high-performing kids might be displaced by poor students with less glittering résumés and lower test scores. To head off such concerns, Marx wants to expand overall admission by 120 or so slots to be reserved for low-income students. Such a move requires an aggressive campaign to raise hundreds of millions of dollars, but

**TONY MARX HAS
A RADICAL PLAN TO
GET MORE POOR
KIDS INTO TOP
COLLEGES,
STARTING WITH
AMHERST**

it also protects affluent kids from facing lower admissions odds.

At the same time, welcoming students who lower the school's 1420 SAT average also could jeopardize its No. 2 position in the *U.S. News & World Report* ranking of liberal-arts colleges—making Amherst less attractive to affluent students. (Williams College is No. 1.) Meanwhile, the influential athletic department is fretting over the impact of Marx's campaign on the school's 67 "athletic admits," who tend to be lower-qualified academically than other Amherst students. And professors fear that since many low-income students, however smart, come from inferior high schools, they will require a lot of help to get up to speed in writing, math, and science. "Because most professors are not fully equipped to handle this, there will be a big debate about how far to go," predicts veteran English professor Barry O'Connell, an ardent Marx supporter.

Marx already has won over many of Amherst's largely liberal professors to the basic concept. He's hoping that by the fall, faculty and trustees will approve a formal plan to give more of

Amherst's coveted slots, perhaps as many as 25%, to students poor enough to qualify for a Pell Grant (usually meaning a family income of less than \$40,000 a year). Doing

so would vault Amherst far ahead of other elite privates such as Harvard University, where 10% of undergrads are low-income. "If we are sufficiently aggressive, we will force the rest of elite higher education to be much more serious about this," says Marx.

Boosting socioeconomic diversity is already a front-burner issue on the campuses of elite colleges. Everyone from Harvard President Lawrence H. Summers to William G. Bowen, ex-president of Princeton University, is grappling with a deeply troubling fact of American life: that 30 years of inequality have all but shut off top colleges to the poor.

Kids from the lowest socioeconomic quartile represent a mere 3% of students at the 146 most selective U.S. universities, vs. 74% from the top quartile, according to the Century Foundation, a New York think tank. It's not just a problem at elite schools, either. By age 24 only 8% of these bottom-quarter students have earned a BA from any U.S. college, vs. 46% of those from top-quarter families, according to Stephen Rose, co-author of the Century study. As educated baby boomers retire over the next 15 years, they will be followed in the workforce by more minority youth who are poor and less likely to have a degree. Says Harvard's Summers: "Social mobility is a central challenge for our country."

Harvard already has a high-profile initiative to bring in more low-income kids. Yale, Princeton, and Williams are undertaking similar plans, though none is as ambitious as Marx's. Bowen, who now heads the Andrew W. Mellon Foundation, a big funder of higher-education research, is on a crusade to win over admissions officers with statistics showing that low-income students succeed at elite colleges. "America's most selective institutions need to put a thumb on the scale" in favor of these students, Bowen argues.

Marx may not have been looking for a job as a campus revolutionary, but in some ways he has been preparing for the role ever since college (yes, an elite: Yale University, class of 1981). He grew up in Manhattan, where his parents settled after fleeing Germany during Hitler's rise to power in 1933. Marx's mother worked as a physical therapist after graduating from the University of California at Berkeley; his father never got a degree but earned a comfortable living as a middle manager at a metals-trading firm.

At Yale, Marx's interest in politics propelled him into the anti-apartheid movement. That led to a job with a South African educational group that was starting a school called Khanya College to help disadvantaged blacks get into the country's elite colleges. It was a formative experience: Security policed the house he shared—illegally—with several blacks and friends were tortured and some even killed. After a year in South Africa, Marx returned to the U.S. to enroll in graduate school at Princeton. But he returned frequently to work on Khanya, spending nearly three years in South Africa on and off while pursuing a PhD in international politics. He learned, he says, that "if you can do this with kids who have suffered under apartheid, then you can't tell me we can't do better in the U.S. with all the resources we have."

LACROSSE MATES

Coaches fret over the plan's impact on "athletic admits"

Poor kids are less prepared academically...

Share of U.S. students scoring above 1420* on the SAT in 2003, by family-income quintile

* The average score of students at Amherst College
Data: Williams College

HIGHEST INCOME	LOWEST INCOME
46%	4%

...so they're shut out of top colleges...

Share of U.S. students at the 146 top* U.S. colleges since 1988, by socioeconomic quartile**

* Measured by student grades, class rankings, SAT scores, and share of applicants admitted
** Defined by the family income, occupations, and education levels of a student's parents
Data: The Century Foundation

HIGHEST QUARTILE	LOWEST QUARTILE
74%	3%

...a result Amherst's Marx hopes to change

He aims to enroll more poor kids by:

- » Raising up to \$500 million, partly to create 120 or so new slots for them. That way, affluent students' admission odds won't be lowered.
- » Doing much more outreach in low-income high schools to find qualified kids.
- » Accepting some poor students with lower test scores.
- » Offering more help to those who are less academically prepared.

Data: Amherst College



College costs are high, even with financial aid...

Share of family income needed to pay for college* in 2003/04, by family-income quartile

HIGHEST INCOME	LOWEST INCOME
11%	47%

* Average annual cost of tuition, fees, and room and board at a four-year public university, minus average annual financial aid received by each group
Data: College Board

...so most low-income kids never enroll in college...

Share of students going to college since 1988 by socioeconomic quartile*

	HIGHEST INCOME	LOWEST INCOME
FOUR-YEAR COLLEGE	64%	14%
NO COLLEGE	11%	64%

...or get a degree

Share of students with a BA by age 24 since 1988 by socioeconomic quartile*

HIGHEST INCOME	LOWEST INCOME
46%	8%

* Defined by the family income, occupations, and education levels of a student's parents
Data: Stephen Rose, Macro International Inc.

TRUSTEES AND ALUMNI

EVEN THOUGH THE BOARD hired Marx to remake Amherst, he's not taking that mandate for granted. First, to give his vision dramatic force, he asked the trustees last year to award an honorary doctorate to Nelson Mandela, whom he came to admire deeply during his years in South Africa. At a ceremony last May in New York, Mandela warned 500-plus trustees, faculty, alumni, and students that "economic inequality [in the U.S.] is growing, not declining. America's great colleges and universities...must open the door more widely. Let Amherst set the pace." The next month, Marx took 30 people, including most of the board, on a retreat to discuss his initiative. To highlight America's rich-poor gaps, he chose Kykuit, the breathtaking Hudson River estate built by John D. Rockefeller Jr. in 1913, when he was the world's wealthiest man. Amid the extensive ceramic, art, and antique car collections, Marx got down to business. He asked the trustees to fantasize about how Amherst could meet Mandela's challenge. "Imagine that Amherst could be free to everyone," he posited. "Get rid of the economic constraints completely. Now, which students would you take?"

Marx also laid out the economics of his campaign. Amherst's

endowment surged 19% in fiscal 2005, to nearly \$1.2 billion, or \$712,000 per student. The college was also wrapping up a \$120 million renovation that will make room for about 100 more students. But it would take hundreds of millions more to maintain Amherst's enviable 8-to-1 student-faculty ratio, plus cover the tuition and extra teaching costs for the new students Marx wants to draw. Could they raise that kind of money? he challenged. By the end of the three days the trustees had begun to plan the largest fund-raising campaign in the college's 184-year history—\$400 million to \$500 million over five or so years.

THE ADMISSIONS OFFICE

THE CENTERPIECE OF Marx's crusade is to change what happens in the converted 19th century farmhouse where Amherst's 14 admissions officers work. Marx is convinced that the process is stacked against poor kids. But changing that threatens the entire admissions rationale of elite colleges. The key issue: how much to lower academic credentials. Amherst got to No. 2 in the rankings in part because of its incoming students' stellar grades and test scores. Those factors are just one part of college rankings, so Amherst might slip only a few spots if other selective colleges don't follow its lead. Still, that could



hurt. "If Marx lets in more low-income kids, he's going to risk his school's reputation," cautions Anthony Carnevale, a senior fellow at the National Center on Education & the Economy.

Right now, Amherst ranks each of the thousands of applications it receives every fall on an academic scale of one (outstanding) to seven (inadmissible). Most students admitted for academic reasons alone are ones, meaning they were at or near the top of their high-school class and scored 1520 or higher on the SAT. Such over-the-top performance typically aligns with affluence. In fact, only 11% of U.S. kids scoring that high on the SAT come from the bottom 40% of family-income brackets, while 75% are from the top 40%, according to a study by the Williams Project on the Economics of Higher Education.

Fortunately for Marx, the person he inherited to run admissions already had a passion for democratizing elite colleges. The son of a high school football coach, Amherst Dean of Ad-

STUDENT GOVERNMENT
PRESIDENT Michael Simmons rebounded from a rough first year

mission Tom Parker was one of the four lowest-income students in the 1969 class at Williams College—"So you know how these places can transform poor kids," says Parker.

Since Marx came along, Parker has been speaking out about a virtually taboo subject: how top universities already bend their standards for all kinds of kids. There are the affirmative action programs for minorities, which most elite schools still run. There are also so-called legacy admits, for whom Amherst reserves roughly 10% of its seats, says Parker. Alumni kids get red-carpet treatment, often including a personal audience with Parker. Yet they rank as twos, on average, he says—meaning that some score three or less and wouldn't be admitted on the academic credentials alone. But top universities simply can't ignore legacy donations. "The way you finance a place like this is with alumni contributions," says Parker.

Then there are the athletic admits, who get 16% of each year's slots. They rank even lower, just 3.5. Amherst reaches clear down to fives—meaning SATs of 1250 to 1300—to snag some hot football and ice hockey players. Given the importance of sports to most elite schools' images, athletic admits are a necessity, too. "If we don't take any fives for football, the team would turn into a travesty," says Parker. "With ice hockey, we'd be talking about not having a team at all."

Bringing in more low-income kids would require additional compromise. To meet Marx's 25% goal, Amherst would have to take more threes, says Parker, meaning those who may have straight As but SATs as low as 1360. Even though Amherst already does so for minorities, legacies, and athletes, faculty members are worried. "This could be a radical departure that fundamentally changes the character of our institution," warns physics professor David Hall, who heads the Faculty Committee on Admissions & Financial Aid.

Marx hopes to ease such concerns by finding more top-notch low-income applicants. Certainly, many students have never even heard of Amherst. So Marx is asking his admissions officers to visit more low-income high schools. And he's enlisting Amherst students in a tele-mentoring program in which they walk seniors from those schools through the college application process. Marx also started using QuestBridge, a Palo Alto (Calif.) nonprofit that has enlisted 8,000 high school teachers to identify talented low-income students for elite colleges.

However noble his goal, Marx's push for a new admissions policy may be opening a Pandora's box. Some supporters think that to make room for poor kids, Amherst should rethink its rationale for letting in less-qualified legacies and athletes. "There is no principled reason to have a hereditary system" of prefer-



The Buzz on Campus

A Talk with Tom Parker: Amherst's Dean of Admission on the secrets of getting into an elite college.

Class Voices Slide Show: Rich and poor students at Amherst discuss their different backgrounds and experiences.

Harvard, West Point, and Smith: What they're doing to attract low-income students.

BusinessWeek online

www.businessweek.com/extras

ces, says Hall. Moreover, "the athletic arms race excludes people who want to learn." Others resent such jocks. Some faculty may see the athletes as "dumb jocks, but in reality they're some of the smartest kids in the country," says Peter Gooding, who stepped down last spring after 27 years as athletic director but has stayed on as soccer coach.

STUDENTS

GETTING INTO A PLACE like Amherst doesn't mean low-income students will automatically thrive, either. Rachel Cardona showed up on the Amherst quad in 2000 from a high school in Harlem, the Manhattan Center for Science & Mathematics. When she was 16 and living in a Brooklyn housing project, her mother mandated that she quit school to care for her four younger siblings. Cardona refused and moved out. She spent the next two years bouncing around, staying with her grandmother, her debate coach, even in shelters. Still, she managed to graduate as the top male student in her class.

To Cardona, Amherst was as foreign as Mars. "I didn't have much exposure to brand names," she recalls, "so when I heard students talking about Abercrombie, I thought it was a person." Her dorm mates got regular phone calls, care packages, and visits from their parents, while Rachel didn't.

The worst indignity was when she put on her apron to work in Valentine Hall, or Val, as the campus cafeteria is known. Although the job was part of Cardona's financial-aid package, it was an alienating experience. "A lot of the affluent students have no consideration for the staff," she says. "Even my friends wouldn't look at me when I was in my apron." After work, Cardona often went back to her room to sleep before getting up to study all night—a grueling routine she found necessary to keep up with classes. After Cardona graduated in December, 2004, Marx hired her as a special assistant to help recruit low-income students and better integrate them on campus.

Val, it turns out, is the crucible of class and other identifying so-

NEW MIX Marx wants low-income enrollees like Isabel Duarte-Gray to make up 25% of the school without losing high-income students like Conor Clarke

How to get into a school like Amherst

Here's the system the college used to rank the 6,300 students who applied for last fall's entering class of 431:

RANK	SAT SCORE	GRADES	WHO TYPICALLY MAKES IT
1	1520-1600	As; valedictorian or near top of class	Most of those admitted solely on their academic performance.
2	1440-1510	Mostly As; top 5% of class	Average ranking of entering class.
3	1360-1430	Many As; top 10% of class	The likely range for some new low-income kids. (Athletes average 3.5.)
4	1310-1350	As and Bs; top 15% of class	Some minorities and athletes.
5	1250-1300	B average; top 20%	Highly desirable football and hockey players.
6	1150-1240	Mostly Bs; top 25%	Not admissible since 2004.
7	Below 1150	Bs or lower	Not admissible. (The national SAT average is under 1050.)

Data: Amherst College

cial markers at Amherst. During meals inside the sprawling Georgian complex, students sort themselves out by race and status. On a fall evening during the supper rush, Michael Simmons, a black student from Chicago, looks over the balcony and decodes the scene. "Down there is what they call the Black Hole," where mostly low-income minority students sit, he says. Over there, at the far end of the cafeteria, "is where the athletes congregate. You can't walk over there unless you play a sport or know a lot of people. It's an unspoken fiat, but it is very well-followed."

Simmons, whose single mother runs a small hair salon, got off to a rough start. He did so poorly in his first semester that Amherst asked him to take a year off. After taking college classes back home, he returned in 2003 determined to buckle down. Now an articulate senior, he sports a B+ average and is the popular president of the student government. Last summer he interned for Senator Barack Obama (D-Ill.) and now has his sights set on law school. Simmons says poorer kids are often put off by the preppy attire and lavish living they can't afford. "Low-income students can come out of here feeling diminished," he says.

To lessen the social dissonance, Marx has set out to get the whole campus talking. He holds meetings for students to discuss class differences and invites smaller groups to come for "fireside chats." His "mission has become very palpable on campus," says Jake Maguire, a junior from Attleboro, Mass. In his talks, Marx discusses ideas such as beefing up an already generous financial-aid program. At Amherst a "full ride," which about 15% of students now receive, includes tuition, room, and board, plus up to \$5,000 extra a year to cover travel, books, and other expenses. Marx wants to add more aid to help poor students buy computers or bring their families to the campus for parents' weekends.

Marx also is talking with low-income students about how to integrate the campus better. Cardona is urging him to require all students to work at Val or at an off-campus job. Simmons wants the college to send all students to off-campus retreats to mix outside the exclusive Amherst bubble. "We have to figure

The plan brings to the fore a little-discussed truth: Schools already **bend their standards** for alumni kids and jocks

out ways to make sure students feel more welcome here," says Simmons, whom Marx appointed to Amherst's Committee on Academic Priorities, a key faculty committee.

THE FACULTY

ECONOMICS PROFESSOR Geoffrey Woglom is the quintessential Amherst prof. Engaging and erudite, he has been teaching economics since he arrived in 1978 from Yale, where he played lacrosse with Senator John F. Kerry (D-Mass.). In his spacious office where his playful spaniel sprawls across the floor, Woglom admits he's nervous about Marx's crusade. The faculty is already struggling to educate all those other students admitted for nonacademic reasons, he says. "I want to make sure we're doing a good job with the diversity we already have."

Woglom and the 200-odd other faculty members have a lot of power. They showed their clout a decade ago when a previous administration lowered admission standards to beef up a woeful football team, the Lord Jeffs (short for Lord Jeffery Amherst, who gave the college its name). Outraged professors demanded—and won—the dismissal of the admissions dean, as well as a nearly 40% cut in football admits, to the current 14 a year. Since the professors will be teaching any new crop of poor students, Marx must assure them they can handle the influx.

So far the response has been mixed, says Faculty Dean Gregory S. Call. Professors understand that just as class background divides students socially, so does it separate them academically. Math professor David A. Cox says his top students

arrive with three semesters of calculus plus linear algebra, while some poor ones struggle just to get through the introductory level. Adds sociology professor Jan Dizard: "There's also a cultural mismatch: Working-class kids tend to come from schools that emphasize following orders, while Amherst values thinking outside the box." Tim Zeiser agrees. A junior whose single mother is a bank teller, he says he wasn't pushed in high school on Long Island and never had to write long papers. "In the first semester I had a 10-page paper due, and I just bombed it."

Marx is all too aware of the problem, which he says reflects the sorry state of U.S. high schools in general. He estimates that 10% to 15% of Amherst students—not just poor kids, either—have difficulty keeping up. That's a remarkably candid assessment from an elite college president. Marx thinks Amherst can meet the challenge. It already invites incoming students with relatively low test scores to a three-week summer science and math program. When school's in session, they can turn to writing and math centers, both staffed by professors and student tutors. Last year they handled several thousand requests.

Now, Woglom and Cox are taking part in an experiment to make rigorous beginner courses more successful. Last fall Woglom taught introductory economics to 10 invited students instead of the usual 28. Week after week he painstakingly helped them work through problems his brightest students would grasp in an instant. "I spent one hell of a lot of time on just 10 students," he says. The payoff: They finished with basically the same average as students in normal sections. Woglom and his colleagues argue that Amherst will have to hire more professors to handle additional low-income kids.

Marx expects to sew up his plan in the spring, taking into account faculty suggestions. A final pitch will go before the board either in late spring or the fall. If he gets the campus behind him, Marx hopes it would "help shift the focus of the American public toward this issue." But even if he succeeds, the practical impact of his crusade isn't clear. Only 20 or 30 colleges have the financial might to contemplate this kind of gold-plated approach. He also fears that if Amherst and others succeed they may just wind up stealing the best poor kids from less prestigious schools.

The questions won't stop him, though. In the end he hopes more students like Cardona and Simmons will inspire the U.S. to work harder to cultivate talent among its poorest children. To Marx this isn't a revolutionary goal; he sees it as a return to Amherst's roots. The college, he notes, was founded in 1821 by Noah Webster, creator of the *American Dictionary*, whose portrait hangs in Marx's office. "The object of this institution," Webster wrote, is "educating young men in indigent circumstances, but of hopeful piety and promising talents. The wording is antiquated, and women weren't allowed back then. But there's nothing dated about the sentiment. ■"

BIO

Anthony Marx

BORN Feb. 28, 1959, in New York. Both parents fled Hitler's Germany in 1933. His father, who worked for a metals-trading firm, never attended college. His mother graduated from the University of California at Berkeley and worked as a physical therapist for kids with cerebral palsy.

EDUCATION Public schools in New York; BA, Yale, 1981; MA, Princeton's Woodrow Wilson School, 1986; PhD, Princeton, 1990.

CURRENT JOB President of Amherst College since July, 2003.

CAREER PATH Political science professor at Columbia University for 13 years while also working on public school reform.

LIFE-CHANGING EXPERIENCE Spent three years on and off in South Africa (above) during apartheid, helping to found Khanya College, which prepared 1,000 young blacks to attend white universities. There he was engulfed in near-civil-war conditions. The house where he lived—illegally—with blacks was raided by police, and friends were tortured or killed.



FAMILY Wife, Karen Barkey, is a professor of history and sociology at Columbia and an expert on Turkey. In 1998 they became the first couple in Columbia's history to win tenure at the same time. Two children: Joshua, 11, and Anna-Claire, 7.

TV-FREE HOUSE No television in the president's residence on the Amherst campus because "the kids were fighting over what to watch."

WHEELS A Volvo, but he plans to switch to a hybrid soon. Likes to bike around Amherst with his kids.

FREE TIME Spends most of it with his children. Vacations in Maine, Cape Cod, Italy, and Turkey, where his wife grew up.

HERO Nelson Mandela, "our greatest living moral icon."



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IN MOURNING Corinne O'Kelly at the New York apartment she and her husband moved to last year

Even in Death, Gene O'Kelly Wanted to Succeed

When the CEO of KPMG learned he had terminal brain cancer, he set out to chronicle his last days

BY SUSAN BERFIELD

IN THE SPRING OF 2004, EUGENE O'Kelly had a premonition: Trouble was coming. He couldn't make out its shape or size, and the only response he could think of was to move from the townhouse in Manhattan he shared with his wife, Corinne, and their 12-year-old daughter, Gina, to a smaller apartment in the city. At the time, O'Kelly was chairman and chief executive of KPMG Inter-

national, the accounting firm where he had worked for three decades. He was 52, at the peak of his career, feeling, as he would later say, "vigorous, indefatigable, and damn near immortal."

A year later he and Corinne had sold their house and most of their furniture and found a light-filled aerie overlooking the East River. Around the same time, Corinne noticed that the right side of her husband's face was sagging. He agreed to see a neurologist after he returned from a business

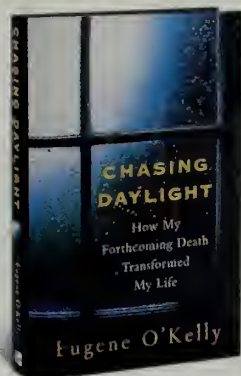
trip to China by way of Seattle, where he would attend the Microsoft CEO Summit. Back in Manhattan the weekend before his appointment, he and Corinne were at a concert with longtime clients when suddenly Corinne bolted from her seat. "I feel like our world is about to blow apart," she told her husband.

Within a week, Gene was diagnosed with inoperable late-stage brain cancer, and, though no doctor would come right out and say so, he knew he couldn't e-

pect to live past the summer. He died at home on Sept. 10. During those 100 days he worked with his wife and writer Andrew Postman to chronicle his attempt to face death with as much brightness, if not hope, as possible. *Chasing Daylight: How My Forthcoming Death Transformed My Life* was published this month by McGraw-Hill, which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies. The book wasn't intended as a guide, Corinne says, but Gene was a mentor, and that instinct remained intact. His advice is simple: Confront your own mortality, sooner rather than later. As he says: "I'll be glad if my approach and perspective might provide help for a better death—and for a better life right now."

Gene was methodical, organized, unequivocating, thorough. He was an accountant by temperament as much as by training. Faced with imminent death, he wanted to be the master of his farewell. "I wanted these things, and only these things: Clarity. Intensity. Perfection.... I was motivated to 'succeed' at death—that is, to try to be constructive about it, and thus have the right death for me. To be clear about it and present it. To embrace it."

In early June he resigned from KPMG, started six weeks of radiation treatment to try to shrink the three tumors and diminish the symptoms (blurred vision, muddled speech, and certain cognitive impairments) that had begun to emerge. And he made a to-do list for his final days: get legal and financial affairs in order, unwind relationships, simplify, live in the moment, create (but also be open to) great moments, begin transition to next state, plan funeral. He recognized how Type A this was, yet what it required of him was the very opposite—let go. As he says: "While I do believe that the business mind-set is, in important ways, useful at the end of life, it sounds pretty weird to try to be CEO of one's own death.... Given the profoundness of dying, and how different its quality felt from the life I led, I had to *undo* at least as many business habits as I tried to maintain."



"I wanted these things, and only these things: Clarity. Intensity. Perfection."

With Corinne's guidance he began to meditate in the morning to help develop the mental discipline they both believed he would need in those last moments of life. It was on one of those mornings, when he had been sitting in the courtyard of the Cloisters, a museum of medieval art in Upper Manhattan, with a fountain running in the background, that he told her he wanted the two of them to write a book about his dying.

SPIRITUAL JOURNEY

CORINNE SAYS NOW that she was initially ambivalent about the idea: At the time she was managing Gene's medical care, meeting with lawyers, concerned about Gina and their elder daughter, Marianne. She knew the project would sap Gene's energy. But he wanted to share what he called his spiritual journey, and he wanted to leave his daughters something. "The last gift I could give him was to let him do it his way and to make his dying as beautiful as possible," Corinne says, sitting in the living room she has only recently furnished.

From that moment in the Cloisters until the last week of his life, Gene wrote

down his thoughts on a yellow legal pad or dictated them to his assistant. He worked intermittently throughout the day while also meeting with colleagues, friends, and family to, as he says, close their relationships. He also kept in touch with the new chairman of KPMG by phone. That summer the firm would admit to criminal tax fraud and agree to pay \$456 million in penalties, a settlement that he

had been working on. (He would say to Corinne: "This can't be another Enron.") Corinne says the fact that the case had been resolved helped Gene die peacefully.

At KPMG one of Gene's priorities had been to change the firm's culture—to make it more compassionate, a place where, he would later say, "we felt more alive." He wanted his staff "to get the most out of each moment and day—for the firm's benefit and the individual's—and not just pass through it." But as the head of the 20,000-employee company, he had remained relentlessly focused on the future, willing to sacrifice his home life for the satisfactions of the job.

In those last few months, though, he came to realize, he says, that his thinking had been too narrow, his boundaries too strict. "Had I known then what I knew now," he says, "almost certainly I would have been more creative in figuring out a way to live a more balanced life, to spend more time with my family." That, says Corinne, was his one regret. He had been getting better at finding that balance before he became sick, she says, but then he ran out of time. ■



Gene's Final Farewells

One of Eugene O'Kelly's hopes in the last days of his life was to be able, as he would say, "to unwind" relationships of all kinds. He placed his many colleagues, friends, and family in five concentric circles; those closest to him were in the innermost ring. He began to say goodbye through e-mail, phone conversations, walks in Central Park, over a good bottle of wine. And always on his terms. He wanted the conversations to be positive, to focus on what he had learned. And, for many people, he wanted these encounters to be the last ones. Toward the end, he says, he realized that during his previous life as a business leader he might have been "too consumed by the outermost circle." As he puts it: "Perhaps I could have found the time, in the last decade, to have had a weekday lunch with my wife more than... twice?... I realized that being able to count a thousand people in that fifth circle was not something to be proud of. It was something to be wary of."

The Spirit Is Willing —But Pills Work

Doctors may decide weight loss is best accomplished with the new Acomplia

BY CATHERINE ARNST

FOR MORE THAN A DECADE, magazines, books, and innumerable diet gurus have nagged us to exercise more and eat less, to no avail. A third of U.S. adults are now obese, compared with 23% in 1994. Americans may set great store by a can-do spirit, but in this critical area, we can't. "Overweight or obesity seems almost inevitable in adulthood," laments an editorial in the Feb. 15 issue of the *Journal of the American Medical Assn. (JAMA)*. We live in a society that does everything it can to encourage a ceaseless march toward the far side of the scale. As a result, a consensus is forming in the medical community: Putting pressure on obese patients to exercise and diet is all well and good, but pills are more likely to take off the pounds.

One pill in particular is on the cusp of winning marketing approval, and it is already galvanizing the weight-loss community. Acomplia, from Sanofi-Aventis, blocks brain signals that stimulate food cravings, with minimal side effects. A study in the Feb. 15 *JAMA* found that 46% of obese patients who took Acomplia for two years were able to lose 5% to 10% of their body weight and keep it off. Grant-



ed, the dropout rate was high (51% of patients quit the trial before a year was out) and the weight loss doesn't sound like much if your starting point is 300 pounds. But health experts say that even morbidly obese people can greatly lower their risk of diabetes and cardiovascular

disease with a 5%-10% weight reduction.

Doctors who treat the weight-challenged will be prescribing the drug with some regret. "I would love to see people turn this around with a change of behavior," says Roger D. Cone, director of the Center for the Study of Weight Regulation & Associated Disorders at Oregon Health & Science University. Our bodies hate behavioral changes, however, and can overcome the best of intentions by fighting hard to keep fat stores constant. Studies have found that 95% of people who lose weight put it back on within three years. "The need for better solutions is huge and medication will play a role," Cone acknowledges.

BLOCKBUSTER POTENTIAL

EVEN PATIENTS WHO LOST WEIGHT with Acomplia weren't home free. Those who went off the drug regained it all. The pill would therefore have to be taken for years to be effective. That's a recipe for a blockbuster. Some investment analysts estimate that Acomplia sales could total \$4 billion within two years.

The drug has only two rivals on the market now: Abbott Laboratories' Meridia, an appetite suppressant, and Roche Holding Ltd.'s Xenical, which prevents fat absorption. But Meridia can increase blood pressure, and Xenical causes diarrhea—side effects that limit the products' usefulness.

Doctors are calling for better medications, and the industry is listening: At least 60 weight-loss medications are currently in development.

Their time has come. An estimated 65% of U.S. adults are overweight or obese, and almost 20% of children. "We

Better **Dieting** Through Chemistry

For some people, a pill may be the answer to prayers

ACOMPLIA Sanofi-Aventis

» The pill blocks brain receptors that stimulate food cravings

STATUS
FDA decision expected soon

PRAMLINTIDE Amylin

» A version of diabetes drug Smylin, this injected drug slows digestion and dampens hunger

STATUS
Phase 2 clinical trials

APD356 Arena

» Pill targets brain receptors that play an important role in regulating food intake and metabolism

STATUS
Phase 2 clinical trials

PYY3-36 Nastech/Merck

» Nasal spray based on a hormone that makes you feel full

STATUS
Entering Phase 2 trials



Tomorrow's water forecast calls for clear, with a good chance for more of the same.

The world's thirst for fresh water is growing faster than nature can provide. It's quickly becoming one of the key resource issues of the 21st century. For two decades, Dow has been the leader in providing one of the most promising solutions. Using FILMTEC™ reverse osmosis membrane technology from Dow, communities in water-stressed areas have access to clean, fresh, affordable water from seawater desalination and from lakes and rivers that were previously unsuitable due to pollution. The world can have quality water for life. All we need is the right chemistry.

Health

Lifestyle

Communication

Transportation

Building



Living.
Improved daily.™

live in an 'obesity-genic' environment," says Dr. George L. Blackburn, associate director of the Nutrition Div. at Harvard Medical School. "[It's] driving us to the inevitable, the entire population becoming overweight."

This environment is constructed out of extremely cheap calories. Waistlines in the U.S. started expanding dramatically only 25 years ago; in 1980, just 46% of adults were overweight. A 2003 study by three Harvard University economists, David M. Cutler, Edward L. Glaeser, and Jesse M. Shapiro, found that Americans are as active these days as they were in 1970, so sedentary lifestyles alone aren't to blame. Rather, we are eating 200 calories more a day than we did 10 years ago, which can add 20 extra pounds a year.

TERRIBLE TEMPTATION

THE HARVARD STUDY concluded that improvements in processing, the rise of fast-food restaurants, and the huge variety of convenience dishes have made calories inexpensive, plentiful, and deadly. One bad player is high-fructose corn syrup, a cheap and easy-to-use alternative to granular sugar that is also metabolized differently. Corn syrup gained popularity in the 1980s and now accounts for more than 55% of the sweetener market. Studies have correlated its use with skyrocketing rates of Type 2 diabetes. Cheap, tasty food "has put us in hedonic overdrive," says Dr. George Bray, an obesity specialist at Pennington Biomedical Research Center at Louisiana State University. "I conclude that this trend is unstoppable."

Doctors do harbor plenty of concerns about handing out weight-loss pills, especially to people who are only slightly chubby. They remember fen-phen, a diet pill combination whose use exploded in the mid-1990s. Some 14 million prescriptions were written in 1995-97, before fen-phen was discovered to cause fatal heart problems and was pulled from the market.

Acomplia seems well-tolerated so far. But what if the drug were taken for years? "We have no idea what the side effects would be," warns Dr. Denise G. Simons-Morton, an obesity specialist at the National Institutes of Health. She would prefer to see society change in ways that would emphasize an active lifestyle, smaller portions, and other forms of prevention, but "I don't see much going on" in that direction. Until there is, for most of us the choice may lie between a pill and a plus size. ■

Rated M for Mad Ave

Video games are white-hot now that Niensens rate their ad impact

BY DAVID KILEY

PLAYERS OF AMERICAN *Wasteland*, pro skateboarder Tony Hawk's latest video game, can't help but see that the undisputed king of the ramps is a Jeep fan. As gamers joystick their way around a digital likeness of Los Angeles, from Venice Beach to the Staples Center, they are bound to run across, or into, Jeep Wranglers, Grand Cherokees, and Liberties.

Of course, the vehicles and the Jeep billboards aren't there by happenstance: They're paid for. Plenty of advertisers, most prominently Coca-Cola, McDonald's, and Nike, have been putting their products in video games for several years now. But marketers and gamemakers successfully pushed Nielsen Entertainment last year to start measuring the impact of in-game product placement, where there had been none before. This in turn is drawing more ad dollars and making gamemakers as eager as TV networks, perhaps more so, to open up their stories to the highest bidders.

The video-game business, already bigger than movie-house box office, did \$10 billion in sales last year. With 100 million gaming U.S. households, according to Forrester Research Inc., and folks increasingly interacting with a video screen instead of passively watching TV, no wonder Nielsen forecasts that ad spending on brand placement in games will balloon from \$75 million last

year to as much as \$1 billion by 2010. Pumping the numbers are the launches of Xbox 360 and Sony PlayStation 3, which connect console gaming to the Internet in a far richer way than previous versions. "This is a new world of interactivity that puts gaming on the same plane with advertisers as cable TV," says Tim Harris, who heads the gaming unit of media agency Starcom MediaVest Group.

Meanwhile, Nielsen's system is generating a lot of compelling data for marketers. In *American Wasteland*, from gamemaker Activision Inc., for example, Jeep learned that all players were shown the 3-D vehicle an average of 23 times in minutes. And 96% of those who recalled seeing the Jeep felt the vehicles fit well in the game. Feedback even more welcome to Jeep: 51% of *American Wasteland* players including some not yet driving, said they would recommend Jeep to a friend, a 65% would consider eventually buying one. "Gaming performs much better than

TV" in turning brand awareness into actual preference, says Bonita Stewart, DaimlerChrysler's director of interactive communications.

Advertisers like the extra control game producers allow them, compared with placements. Ford Motor Co. didn't know until episodes of Fox's *24* were in the air just how its vehicles came off looking on screen, but Chrysler and Activision executives have extensive back-and-forth d



"Gaming performs much better than TV" with a coveted audience



SELLING JEEPS
What would Tony Hawk drive?

cussions during the game's development. "I understand that the TV and writers in Hollywood see it as an invasion of their space, but with gamers we're treated more like a private equity investor," says Stewart. Activision CEO Robert Kotick says the company took in \$1 million in brand placement dollars from Chrysler, Nokia, and Motorola. That's 10% of *American Wasteland's* \$20 million development costs.

Game cartridges that are bought and sold are attractive to advertisers, but the surge in the gaming predicted some as gamers replace sets with Xbox 360 and PlayStation 3 has the marketers lining up. Rather than simply burn billboard ad images into game scenes, advertisers will be able to buy spots of ads and placements that last a day, a week, or a month and producers keep the ads fresh by collaborating on sponsored Web content that ties into the game. The next Tony Hawk game, says Activision's Kotick, could include not only brand portals that draw gamers in connected sites but also features such as Internet phone calls—by way of

clicking on a branded cell phone—with changing messages from Hawk that alter the game experience. "Staying competitive in a new era absolutely depends on ad support, and we're not interested in ads that don't make sense or [that] annoy," says Kotick.

So far, gaming companies and marketers are exhibiting good sense for what is "natural" product placement. Jeep vehicles and Nokia phones are, after all, popular with young men. And Nike recently inked its largest gaming deal ever, joining with Take-Two Interactive Soft-

ware Inc. to put its brand into the NBA *2K Sports* basketball games. Some 200 athletes in the games wear the Nikes they wear on the court. But the new version integrates the company's Web-based Nike iD shoe customization software, which enables players to design and personalize shoes worn by the digitized pros.

"SEEDIER SIDE"

BUT AS THE placements proliferate, some advertisers are committing a few fouls. One recent flap involved Engage In-Game Advertising, a company that inserts ads into online games via a Net ad server. Engage modified the

popular game *Counter-Strike*, created by Valve Corp., and dropped in ads from its client, the Subway sandwich chain, over three weeks in December. The problem: They changed the game without asking Valve for permission. Engage has drawn ire from the game creator—and brickbats on message boards and blogs. "Advertising within video games...does have its seedier side," writes arstechnica.com, a tech enthusiast Web site, about the Engage incident.

Now that Nielsen can quantify the audience for advertisers, game producers would like to move toward a more stable system by which advertisers can buy ads, such as a cost-per-thousand formula, the same way they buy time on TV. That means stiffer competition for media already under pressure from youthful eyes deserting afterschool and prime-time TV for gaming. The cost of a 30-second spot for shows like *The Simpsons* and *CSI* can range from \$250,000 to \$400,000, but 18- to 34-year-old males represent only an average 37% of those audiences, while 65% of video-gamers fall into that valuable demographic. "If the goal is to reach [young] males, there is a lot of waste in buying network television," says Nielsen Entertainment Senior Vice-President Michael Dowling.

Why are consumers drifting away from TV for more gaming? Players see themselves in the games, something that's difficult with TV shows. And far from rebelling against ads in their players, gamers seem to be telling advertisers they want to see more of the brands that help define who they are. No video-game TiVo or ad zapper needed, at least not yet. ■

The Gaming Gold Rush

Ad dollars are piling into video games now that the payback for brand placements is being measured by Nielsen Entertainment. Advantages include:

MORE NATURAL THAN TV A majority of players in a study by Nielsen said that advertising relevant to them and to the game actually enhanced the quality of play.

A DEMOGRAPHIC TO KILL FOR Video games are strongest among 13- to 25-year-old males, who are watching less TV. Women and even baby boomers are also turning to games for fun, as well as to bond with kids and grandkids.

FRIENDLY PERSUASION TV ads generate awareness, but the interactive and repetitive nature of video games packs the power to get gamers to consider purchase, according to the new gamer data.

REAL INTERACTIVITY Linking the Internet with games in a bigger better way, made possible by Xbox 360 and Sony PlayStation 3, opens up a new universe of ad possibilities, including changing ads daily and giving online brand portals a bigger role in the game.

How to Ride a Housing Bubble

Golden West specializes in exotic mortgages—and in surviving downturns

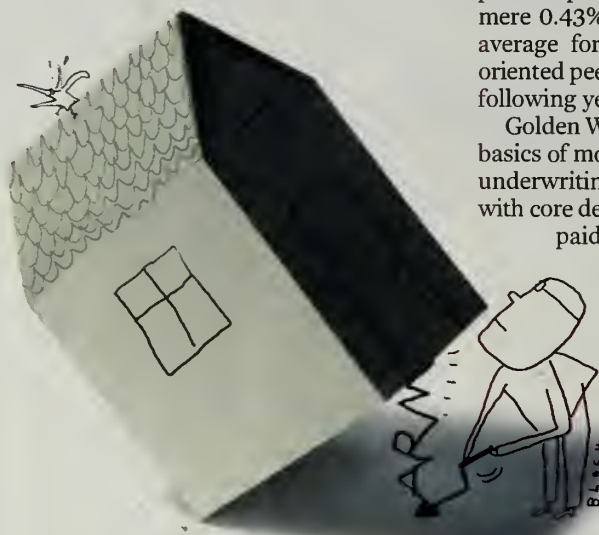
BY JUSTIN HIBBARD

THE STORY IS FAMILIAR TO anyone following the housing boom. A California savings and loan did a brisk business in adjustable-rate mortgages. People who previously couldn't afford homes piled in. Then the Federal Reserve started hiking interest rates, and mortgage payments began to climb. Home prices eventually started falling, making it harder for owners to sell or refinance. Analysts predicted a wave of defaults and much pain for shareholders.

The thing is, our yarn took place in 1994. The S&L in question was Oakland-based Golden West Financial Corp., which has offered its Pick-A-Payment loans since the U.S. government first allowed adjustable-rate mortgages, or ARMs, in 1981.

The naysayers couldn't have been more wrong about \$20.6 billion Golden West. It wasn't crippled by defaults during the last housing bust. In fact, it held up better than anyone expected. And Golden West should do the same this time, too.

Adjustable-rate mortgages are once again high on analysts' worry lists. Given the Fed's recent rate hikes, some lenders will be hit by defaults as borrowers find it more difficult to make their payments. Analysts have already issued warnings about Washington Mutual, Countrywide Financial, and FirstFed Financial, along with Golden West.



But ARMs aren't frightening to Herbert M. Sandler. He and his wife, Marion O. Sandler, have been co-chairman and co-CEO of Golden West since they founded the company in 1963. For 25 years the pair has offered so-called pay-option ARMs, which let borrowers choose from among various low-payment scenarios each month, with the principal and interest recalculated accordingly.

These loans are the most sensitive to rising interest rates, because their rates reset every month. While option ARMs are big at WaMu and the others, they're Golden West's No. 1 loan product by far.

But the Sandlers have survived rate hikes before, and their long-term success is unrivaled among mortgage

lenders. Over the past 39 years of housing booms and busts, Golden West's earnings have grown at a compound annual rate of 19%, a record matched in U.S. business only by Warren Buffett's Berkshire Hathaway Inc.

PERFECTING THE BASICS

THE SANDLERS' 1994 performance was impressive. In California, where 78% of the company's loans were concentrated, the jobless rate jumped to 9.4%, while home prices fell 4.5%. Moreover, the Fed raised banks' overnight lending rate from 3.25% to 5.5% that year, often in big half-point leaps. Yet Golden West charged off only 0.43% of its loans in 1994—about average for its conventional-mortgage-oriented peers, but hardly disastrous. The following year charge-offs fell to 0%.

Golden West's secret? It excelled at the basics of mortgage lending: conservative underwriting practices, funding loans with core deposits, and balancing interest paid on deposits with interest earned from loans. Even though the loans were risky, the customers, for the most part, weren't. Herbert Sandler dismisses the hand-wringing now. "We have been through high interest rates, low interest rates, and sideways interest rates, and not very much exciting has

happened," he says.

Still, analysts are sounding the alarm. In a recent report, Christopher Whalen, independent research firm Institutional Risk Analytics reiterated his sell rating on Golden West, calling it "the poster child for the U.S. real estate bubble." In an interview, Whalen added: "There is no flexibility in its portfolio."

He has a point. Last year pay-option ARMs made up 99% of Golden West's loan pool. (It also offers home-equity lines of credit.) And 62% of the loans were secured by homes in California, where housing prices could fall in coming years.

But Golden West's risk management among the best in the industry. Its annual default rate has been lower than that of its peers for years. Golden West maintains a higher-than-average percentage of assets in cash to cover losses. And the Sandlers don't lend to the riskiest borrowers with spotty credit histories.

Golden West's conservative strategy will be put to the test if housing tanks. For now, though, it looks like history is on the Sandlers' side. ■

TRADERS AREN'T WORRIED

Golden West has handily outperformed its peers



if you need help
or can help out with
construction services
or products in the
Gulf Coast region, go to
www.katrina.construction.com

Recover.

Rebuild.

Rebound.

Steering Patients Through the System

Quantum Health points people to the best care—and saves employers big bucks

BY PALLAVI GOGOI

FOR KARA J. TROTT, BECOMING an entrepreneur meant leaving her corporate law career. It meant resigning from a nonprofit board she no longer has time for and giving up her vacations. And in the early days it meant taking out a home-equity loan and moving to a smaller house.

But the new Kara Trott—the super-busy one in the more modest home—has never been happier. The company she started in 1999, Quantum Health in Columbus, Ohio, helps patients navigate the complexities of the health-care system. “When someone is diagnosed with cancer or diabetes, it is the most difficult time in their lives,” says Trott, 44. “It gives me the greatest satisfaction that I help people make the right decisions during those critical moments.”

In her prior life many of Trott’s legal clients had been hospitals or doctors. She witnessed the insurance industry’s attempts to shift health-care costs by cutting reimbursements to physicians and hospitals and by increasing employees’ deductibles and co-payments. Trott also had worked as a consumer products consultant, and she thought some of the techniques used in that industry, such as providing incentives to get people to buy, could be applied to health care to encourage patients to reduce spending. That would help everyone in the system, from patients on

up. “I wanted to create something and make a change in people’s

SELLING WELLNESS

Trott’s pitch isn’t just about money

lives,” says Trott. “Of course, everybody was skeptical.”

Undeterred, she tracked health-care decisions from 2,800 patients, 260 physicians, and 140 employers, using data supplied largely by her law firm’s clients. She found that half of



patients left their physicians’ offices not knowing what to do. Only 15% got answers to their questions, and 61% of the time patients chose the wrong type of specialist. That misstep generated an average of \$3,500 in extra costs. And Trott found that most patients wanted more guidance in choosing health care.

Data in hand, Trott quit her job. She told employers that her company would call their employees when they made doctors’ appointments. Quantum would assign the employees with pertinent questions to help them choose the right specialist, give them advice about which tests to take, and ensure that tests weren’t duplicated. Quantum would get a percentage of any savings the employers reaped. It would also offer workers incentives to stay well, such as by slashing co-payments for preventive care visits.

Her pitch worked. Trott’s first customers, mostly small, self-insured companies, averaged 6% increases in their health-care expenditures in 2001, compared with a national average of about 1% at the time. In 2004, according to a study of 600 patients

by Appleton (Wis.) benefits consultant Associated Health Group, Quantum made 970 telephone calls to patients, compared with 27 by a disease management company assigned to assist employees with chronic ailments. “Quantum takes disease management to the nth degree,” says Associated’s vice-president, Jeff Prickett.

Still, the first few years were slow going. “In the health-care business it takes an average of three years before people believe that results you’re generating aren’t an anomaly,” says Trott. She invested \$400,000 of her own money and raised \$300,000 from family and friends before taking out a Small Business Administration-backed loan in 2004 for \$730,000. In 2002 she hired a professional management team, including her husband, strategy consultant Randy Gebhardt, as COO.

Now, Quantum is on a tear. Last year the number of patients Quantum oversees doubled, to 52,000. Trott doubled her own employee base, to 55, and 2005 revenues shot up 40%, to \$7 million. “If we had gone to employers in 1999 talking about the importance of wellness and disease management, they would have laughed me out,” says Trott. Now they’re begging her to come in. ■

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~~I don't ship enough to get discounts.~~

~~My life coach says I should ignore money and focus on hugs.~~

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Digital Books Start A New Chapter

Lighter devices, better displays, and the iPod craze could make them best-sellers

BY BURT HELM

RICHARD D. WARREN, A 58-year-old lawyer in California, is halfway through Ken Follett's novel *Jackdaws*. But he doesn't bother carrying around the book itself.

Instead, he has a digital version of Follett he reads on his Palm Treo each morning as he commutes by train to San Francisco from his home in Berkeley. He's a big fan of such digital books. Usually, there are around seven titles on his Treo, and he buys at least two new ones each month. "It's just so versatile," he says. "I've tried to convert some friends to this, but they think it's kind of geeky."

Geeky? For now, maybe, but not for much longer. Many experts are convinced that digital books, after plenty of false starts, are finally ready for takeoff. "Every other form of media has gone digital—music, newspapers, movies," says Joni Evans, a top literary agent who just left the William Morris Agency to start her own firm. "We're the only industry that hasn't lived up to the pace of technology. A revolution is around the corner."

What developments have won over people like Evans? Portable devices are becoming lighter and more appealing. Books are being scanned into digital form by the thousands. The most important step forward may be in "digital ink," the technology used for displaying letters on a screen. A small company called E Ink has created a method for arranging tiny black and white capsules into words and

images with an electronic charge. Because no power is used unless the reader changes the page, devices with the technology could go as long as 20 books between battery charges. The text also looks just as sharp as ink on a printed page, since each capsule is the size and pigment of a grain of laser-jet toner.

Sony is the first major player to take advantage of the technology. This spring, it will debut the Sony Reader, which uses E Ink and closely mimics the size, weight, and feel of a book. The Reader will sell for about \$400. Sony also will offer roughly 10,000 book titles for download from its online store, along with news stories and blog items.

Other players sniff opportunity, too. At least two more companies are introducing digital readers this year. And scores of companies, from Google to Random House Inc., are angling for other ways to profit from digital books. Chalk it up to the influence of Apple Computer Inc. With its iPod, Apple

has demonstrated that millions of people are willing to carry around digital devices with their favorite content. After music, why not novels and nonfiction? "The iPod led the way in getting people comfortable with [a similar device for books]," says Jack Romanos, CEO of Simon & Schuster Inc. "These things are not only inevitable, but a good idea."

No book company has come close to Apple's magic touch. But the technology, availability of content, and consumer behavior may be aligned for a breakthrough this year. "The puzzle pieces are on the table," says Timothy O'Reilly, founder of



SONY READER
Going for the look and feel of a bound book



the tech publisher O'Reilly Media. "You've got the critical mass of content and you've got attractive hardware. What we don't have yet is an attractive business model that connects them all together." Sony is clearly attempting to pull off the feat. Its combination of device and online store is reminiscent of Apple's approach. The Reader is impressive: a slim, sturdy package that weighs nine ounces and comes bound in heavy faux leather. But it's unlikely just yet to become the kind of hit Apple has on its hands. The Reader's controls can be clumsy to use. Plus, books for the device will cost about the same as books from megastores like Barnes & Noble, and readers will have to search the Web on their own to get classics that have gone off copyright for free.

The other makers of digital readers are treading cautiously. Jinke, a Chinese company, plans to sell into the education field in China and other markets. But it declined to comment in detail or plans. IRex Technologies, a spin-off of Royal Philips Electronics, says it will make a device available for sale by April. CEO Willem Endhoven says the company



searchable online. The effort has drawn the ire of publishers and authors, since it's digitizing some books still under copyright. Publishers sued last fall for copyright infringement and the case is pending. (One of the plaintiffs in the case is The McGraw-Hill Companies, the parent of *BusinessWeek*.)

NEW LITERARY MODELS

YET GOOGLE IS HELPING ignite the digital market. In November, following the lawsuit, Random House announced plans to digitize 25,000 titles. It will sell access to them to consumers, charging a per page rate for everything from novels to recipes out of a cookbook. In December, HarperCollins Publishers Inc. said it would build a digital warehouse of its entire holdings—another 25,000 titles or so—which it may later sell over the Net.

Amazon.com is moving aggressively into digital books, too. It sells digital versions of most of its titles, available for download instantly. In August, it launched Amazon Shorts, a collection of stories, novellas, and essays that can be downloaded for 49¢ apiece. Later this year it plans to offer shoppers who purchase traditional books the chance to buy a version they can read on the Web, too. That way they could keep Stephen King's *Cell: A Novel* on their nightstand and read a chapter from any computer with Net access. "We think consumers increasingly are ready for it," says Steve Kessel, vice-president for worldwide digital media.

Authors are intrigued by the opportunities to go digital. George Saunders, a short story author and professor of English at Syracuse University, says he'd like a way to get his work out to readers more quickly. After the scandal broke over James Frey's falsehoods in his hit book *A Million Little Pieces*, Saunders penned a humorous essay stemming from the events. It was a confession to Oprah Win-

frey that all of the fiction he'd written had, in fact, been true. But Saunders had a hard time getting the piece published quickly, and now it feels dated. "There might be a different model for a literary community that's quicker, more real-time, and involves more spontaneity," he says. If digital books finally do take off, they could change not only how we read, but what we read, too. ■

begin by selling to companies, such as newspaper or textbook publishers, rather than directly to consumers.

There are sure to be other companies to introduce readers in the months and years ahead. Plastic Logic Inc., a British startup, is working on a flexible display the size of an 8½-in.-by-11-in. piece of paper that can receive books, news, or e-mail wirelessly. It's partnering with Verizon's NTT DoCoMo and plans to have a product on the market by early 2008.

There's even speculation that Apple could come out with its own device, an iPod designed for books. The secretive company hasn't said anything publicly and declined to comment for this article.

Just as digital readers are hitting the market, the number of books on the Net is swelling to Library of Congress proportions. Google, through an initiative it began a year ago, is scanning millions of books from five of the world's largest libraries and plans to make the contents

Read all about it... **Digitally**

Digital devices for reading novels and nonfiction have had plenty of false starts. By 2006 could be different.

NEW TECHNOLOGY A display technology called E Ink makes words look as sharp as text printed on a piece of paper. A single battery can last for months. Plastic electronics will let devices be flexible like a magazine.

THE GOOGLE EFFECT The search giant is scanning books as fast as it can and then putting them online. Publishers and tech players are pursuing similar projects. More books will be available online than ever before.

READERS' HABITS People are warming up to reading on digital displays. More people scan blogs and news sites by computer and browse text messages on mobile phones.

Boot Up the Band

Technology is making it easier to compose, perform, record, and promote your own music.

YOU MAY NOT REALIZE IT, BUT IF YOU HAVE a PC or Mac at home you've already got the guts of a professional home music studio. Whether you're a lapsed amateur or a newbie musician, we'll help you figure out the gear you'll need to start making your own kind of music. We've looked at everything from portable keyboards to digital guitars. We'll point you to the software you'll want to use to converse in MIDI, the Musical Instrument Digital Interface that is the computer language of music. We'll help you hook everything up. (It's pretty easy, actually: *Music Trades* magazine called last year "the year of the USB port," as everything from microphones to digital pianos sprouted the ubiquitous computer connection.)

Rockfest or recital, once you've performed or composed, and recorded and edited your music, what can you do with it? We've taken a look at Web sites that will host it, judge it, and even promote it. Pretty soon, you can quit your day job—or not. Stay tuned for our May 15 issue, when our next Personal Tech guide will help you work more effectively on the road. That should leave you with more time for jam sessions when you're home.





KEYBOARDS

Plug 'N' Play Pianos

There's a digital keyboard to tickle everyone's fancy.

BY LARRY ARMSTRONG

LIKE MANY PEOPLE, I USED to play—a piano here, a church organ there, a couple of brass instruments in my high school and college marching bands. Then my adult life intruded, leaving me with neither the space nor budget for a piano, nor the time to do anything with music except listen to it.

Now I want to play piano again. But, man, has the landscape changed. The familiar acoustic piano, with hammers that hit strings, seems almost quaint. As a piece of furniture, it's still impressive. But unless you spend big, it won't sound half as good as even a low-end portable keyboard that stores digital samples of actual notes played on a grand piano.

Consider the portable keyboard's other advantages. You can bring it home from the store in a car. You can easily move it from room to room, to a vacation home, or into a closet. You never have to tune it. You can plug in headphones and play it without disturbing your family or neighbors. With most keyboards, you can press a button and it won't sound like a piano anymore: It can mimic a violin or guitar or any other instrument you want to hear.

Prepare to be overwhelmed by the choices. Besides your budget, you need to think about your level of musicianship and what you want a keyboard for before you head out to the store. Do you want to learn to play the piano? Or do you just intend to pick out the melody while a band-

CALEF BROWN

in-a-box follows along as you play? Do you plan to hook up the keyboard to a computer to compose and record your own accompaniments or songs?

Let's say that you or your child is serious about wanting to learn to play the piano or, like me, were trained on an acoustic piano. You're interested in piano music instead of, say, sounding like a rock group or a string ensemble. Then, most likely, you want a digital piano; the portable varieties are usually called stage pianos. It will look like a traditional piano keyboard, with 88 beefy, block-shaped keys (most portables have 61). The keys will have a weighted or hammer action that simulates the touch or feel of the mechanism of an acoustic piano key.

Just a few years ago, you couldn't get that kind of digital piano for less than \$1,000. Now, Casio's 18-month-old Priv-

Spend more, and you'll get more—but even the cheap models come loaded

tones. Or maybe you'll find you prefer other sounds, such as the artificial sounds of a synthesizer, and decide you'd rather spend your money there.

The most inexpensive portables have more than a hundred sounds, from a basic piano to strings and woodwinds, guitars, brass instruments, synthesizers, and even sound effects. And they come with about a hundred built-in songs to listen to and learn to play. Their touch is lighter, more like a synthesizer or organ. Even the most basic ones come with on-board software that teach you to play by showing you which keys to press. On some of them, the appropriate keys light up.

Yamaha and Casio pretty much domi-

tar, and strings—as your right hand plays the melody, it can turn you into a one-person band. Yamaha's DGX-505, which sells from \$500 to \$600, looks and plays more like an 88-key piano, but with nearly 500 sounds. For about the same price, Roland's 61-key E-09, with close to 90 tones, is more like a synthesizer.

If you decide you don't like the idea of canned accompaniments, the cheapest way to write your own is to use your computer. Hook up a keyboard controller, such as E-MU's Xboard 49 or M-Audio's Oxygen 8. They don't have speakers; instead, they send data, such as which key was pressed and for how long, to the computer, which uses a sound card to play the music. (Even the cheapest portable keyboard, outfitted with a pair of MIDI cables, can do the same thing.)

Or you can buy a keyboard workstation

IVORIES TO GO

Portable keyboards now have a wide range of capabilities and prices. We looked at these popular models:



	ENTRY LEVEL KEYBOARDS		88-KEY DIGITAL STAGE PIANOS		SYNTHESIZER	MIDI CONTROLLER
MODEL	Casio CTK-700	Yamaha PSR-293	Casio Privia PX-110	Yamaha P-70 (above)	Korg Triton Extreme 61	E-MU Systems Xboard49
PRICE	\$93 - \$100	\$198 - \$230	\$400 - \$500	\$600 - \$718	\$1,900	\$165 - \$170
THE LOWDOWN	Full-size keys and built-in songs and styles make this a good starter keyboard	This beginner's model can record your songs, and there's a USB port for your PC	This "portable" is the least expensive model to mimic the touch of an acoustic piano	This new model best captures the sound and action of a grand piano at a low price	It's got plenty of sounds, and the touch screen makes programming songs easier	The rock-solid keybed makes this the best for sending music data, not sound, to a computer

Data: BusinessWeek

ia PX-110 goes for \$400 to \$500. Yamaha's new P-70 electronic piano is not much more. Each has about a dozen sounds, usually a half-dozen different pianos (perhaps two grand pianos, the Wurlitzer and Fender Rhodes pianos from the '60s and '70s era of classic rock, and a honky-tonk piano), an organ or two, and a harpsichord. There aren't many nonpiano sounds; these keyboards are designed mostly for playing a piano repertoire.

If you're a beginner, you're probably better off starting with a cheaper, entry-level portable keyboard that has a lot more sounds and without the heavy touch of a digital piano. Later, if you find that piano's your gig, you can invest in a keyboard with a more lifelike feel and

nate the electronic keyboard market, and both sell keyboards in the \$100 range. Two picks for beginners: Casio's \$100 CTK-700, or Yamaha's \$200 PSR-293. The biggest difference? The more expensive one can record your songs, and it has a USB port that makes it easy to save your recordings on a computer, or download prerecorded songs from the Internet.

The more you're willing to spend, the more you'll get: More songs and styles, which are rhythmic backgrounds such as rock, jazz, hip-hop, salsa, or even polka; a slot for a memory card so you can save your performances; a liquid-crystal display that shows the sheet music or lyrics.

Next up is the so-called arranger keyboard. By automatically playing backing tracks—such as drums, bass, piano, gui-

to compose, arrange, and mix compositions without a computer. This all-in-one machine has a keyboard, synthesizer, a sampler for creating sounds, and a sequencer that can record, edit, and playback music data. Adventurous amateurs like Korg's 61-key Triton Extreme for its touch screen, which makes navigating quick and easy.

When you're shopping, take headphones so you can hear the sound quality over the din of the store. Play several models to pin down what kind of touch you like best. If you're a beginner, consider taking along a friend who plays. Don't be intimidated: Today's portable is a breeze to play, and you'll be amazed at incredible sounds you'll hear within minutes of taking it out of the box. ■

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GUITARS

A New Twang For Six Strings

A few pioneers are working to bring the trusty old electric into the 21st century. **BY DAVID ROCKS**

GRAB JUST ABOUT ANY electric guitar these days, plug it into an amp, crank up the volume, and you'll hear a sound not that far removed from what the pioneers of the industry heard seven decades ago. Pickups, which work sort of like tiny microphones, sense the vibration of the strings and translate that into electric waves. The signal flows through a wire to your amplifier, and you get to wake up the neighbors.

And digital electronics? Sure, effects pedals such as delays, choruses, and

flangers have been digital for a couple of decades, but the guitar itself remained a largely analog affair. Now a handful of pioneers are finally experimenting with ways to adapt the trusty old electric guitar to the digital era. Three have newfangled pickups that digitize the sound before sending it to the amplifier. A fourth uses standard pickups, but has tiny lights along the fretboard to help guitarists learn how to play new chords and scales.

Perhaps the coolest of these new axes come from Line 6. The California company got its start as a maker of digital effects pedals and amplifiers that mimic the sounds of classic gear from the '50s, '60s,

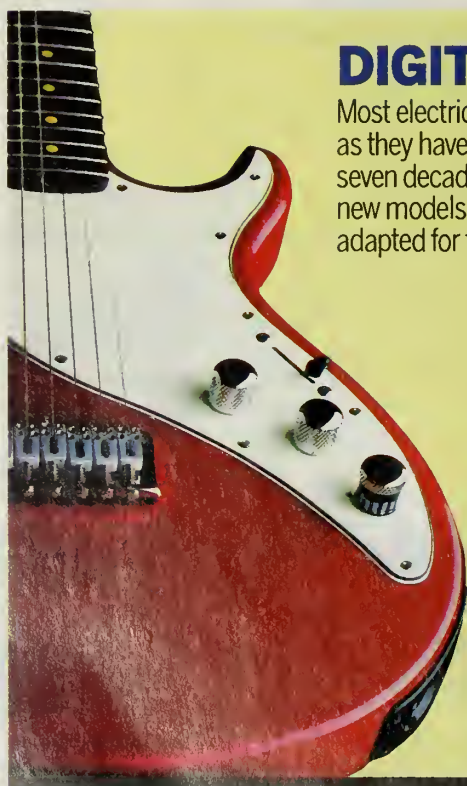
and '70s. Then a few years ago it gave engineers a related but more complex task: Make a guitar that can emulate classic models such as the Fender Telecaster, Gibson Les Paul, or Rickenbacker 360.

They came up with the Variax, among the oddest-looking instruments on the market. The reason: The Variax has no standard pickups, so it appears almost naked. Instead, the Variax uses a pickup at the bridge (where the strings are anchored to the guitar's body) that turns the vibrations into a digital signal. This signal is then modified to make the Variax sound like classic electrics as well as other instruments such as the banjo, an acoustic or string guitar, and more—some 25 in all. Today, Line 6 makes several variants of the Variax, including a bass and an acoustic, priced from \$500 to \$1,500.

Another digital offering comes from Gibson Guitar. The Nashville-based manufacturer has updated its classic Les Paul guitar with a patented pickup that converts the sound to bits and bytes before sending it down the cable to the amp. What's the advantage of this? For starters, it's a lot quieter. Standard electrics make a lot of hissing and humming noises that are the bane of guitarists. Another benefit is that the sound can be divided up into separate streams, one for each string. This lets you send the sound of each one to a separate amplifier with different effects, opening up a huge range of mind-bending

DIGITAL AX

Most electric guitars work much as they have since their invention seven decades ago. But some new models have been adapted for the digital era



BRAND	iGuitar	Optek	Gibson	Line 6
PRICE	\$800	\$500	\$3,000	\$500-\$1,500
THE LOWDOWN	This small New York company, formerly called Brian Moore Guitars, makes an ax that can plug directly into a computer to control software-based synthesizers.	Optek's Fretlight, a clone of the Stratocaster, has lights on the fretboard that show guitarists where to put their fingers as they learn new chords and scales.	The maker of the venerable Les Paul solid-body offers a digital model that can separate the signal from each string for individual processing.	Its Variax models—both acoustic and electric—digitize the sound of the strings, then tweak it to emulate the tones of classic guitars.

Data: BusinessWeek

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possibilities. For traditionalists, the guitar also has a pair of classic humbucking pickups that sound, well, just like a Les Paul. The downside: the \$3,000 price tag.

As PCs become the hub of music production and more home musicians start recording in the spare bedroom, one problem is getting the sound of the guitar into the PC. iGuitar, a small custom shop based in Poughkeepsie, N.Y., has for several years made guitars that can plug into a PC. But they always required a connecting box, special software, and various cables. Later this year iGuitar plans to introduce an \$800 model that can connect directly to a PC via a single USB cable.

GUIDING LIGHT

THIS SIMPLIFIES THINGS considerably. The PC immediately recognizes the guitar as a peripheral such as a printer or external hard drive. The cable can handle both the audio signal from traditional pickups and a digital signal that allows guitarists to control software-based instruments in the PC that can produce the sound of, say, a piano, a drum kit, or an orchestra. And it can be used to trigger software that will translate notes played on the guitar into musical notation.

A fourth company uses electronics to make learning to play easier. Optek Music Systems sells the \$500 Fretlight, a guitar that looks much like a classic Fender Stratocaster. But as its name implies, the Fretlight's fretboard has tiny red lights at every string position on every fret. When the guitar is plugged into a PC (via the USB port with a special cable), the lights show where to put your fingers to play various chords and melodies. When used with a software package called M-Player, the lights can guide you through songs. And you can put on the brakes to slow the tempo to as little as 10% of the original beat, which lets you see the lights before it's time to move on to the next chord.

Will digital guitars ever replace analog? Probably not. A lot of the reason musicians like electric guitars in the first place is their unpredictable analog sounds. Much of the beauty of the Stratocasters and Les Pauls that Line 6 seeks to emulate comes from flaws in the analog signal, which create a distinctive, distorted sound. But as PCs get more powerful, digitals will surely take an ever-bigger piece of the market. Don't worry, though: Whether you're playing an analog or digital guitar, you can still wake up the neighbors. Just crank up the volume. ■

HOME RECORDING

Your Very Own Hit Factory

With the right software and a lot of patience, that spare room can be a serious studio. **BY DAVID ROCK**

IT SEEMS LIKE A COMMON career trajectory: Pimply faced rock star wannabe. Member of a band that's gonna be really big, really soon, Mom, I promise! Ex-member of band that no one remembers. Responsible working stiff and parent. Gray-haired rock star wannabe.

In my 20s, I played guitar, sang, and wrote songs for a long-forgotten Burlington (Vt.) quartet we dubbed The Jetsons. Then a couple of years later, while living in Eastern Europe, I was the lead singer for Pudelsi (The Poodles), a combo that actually went on to be a top-selling act. In Poland. A decade after I left the country.

When I quit Pudelsi in 1987, I thought I was hanging up my guitar for good. But left over from those days as an aspiring rocker were dozens of songs I never got around to putting on tape. So when I rekindled my interest in music a couple of years ago, I thought the time had come to finally flesh out and record those songs—mostly just lyrics and guitar chords, the musical equivalent of a sketch.

In the digital era, I had heard, all you needed to make really great recordings was a guitar, a microphone, a computer, and some inexpensive software. That's true, but it isn't exactly easy. Two-plus years into my transition from rocker wannabe to budding recording engineer, I'm finally starting to turn out tunes that sound pretty good to me and to friends who are polite enough not to tell me otherwise. Still, professionals assure me there are plenty of flaws, so I know I have a long way to go.

If you're planning your own home hit factory, the most important thing you'll need is software. There are now at least a dozen music recording packages available, ranging from basic to extravagant. For anyone with a Mac, the choice

is easy: Apple Computer's excellent GarageBand program comes free with any new computer. Mac owners who want to graduate to a more complex offering can use Apple's Logic, available in \$299 and \$999 versions. For PC users, things get a bit more complicated. At least a half-dozen companies offer decent packages, many priced under \$100. I use Cakewalk's Sonar Home Studio (\$100-\$160) and have tried its \$40 Music Creator and Steinberg's \$100 Cubase SE, all of which let you record various instrument and vocal tracks and add software-based synthesizers to round out your sound.

Once I had my software, I thought I'd be ready to plug in and go. Not so fast. Few guitars generate a signal that's strong enough for a computer to hear clearly. I was stymied until I figured out that I needed some kind of amplification.

GEAR UP

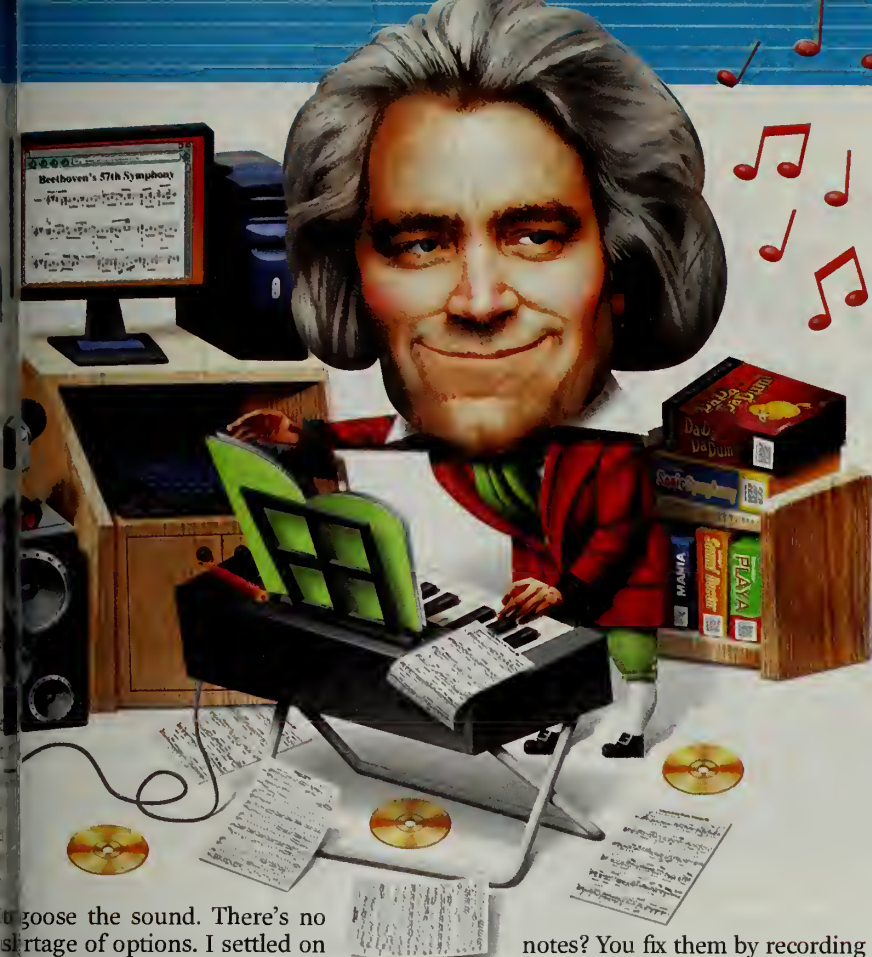


EDIROL UM-1EX USB MIDI INTERFACE

\$40

edirol.com

If you want to save or edit your songs on your computer, but the music keyboard or controller you own doesn't have a USB port, this is the easiest way. It works with PCs and Macs, and is ideal for laptop computers, where connections are limited. The cables are built in, and there are indicator lights to show which way the music signals are moving. And unlike traditional MIDI interfaces, this one doesn't need an AC adapter.



to goose the sound. There's no shortage of options. I settled on the \$250 M-Audio Ozone, a pre-amp with two inputs (one for a microphone, one for a guitar) plus a 25-key piano keyboard. Manufacturers such as Tascam, Line 6, and Edirol offer pre-amps for about \$80 to \$500 or more. All Cakewalk, Steinberg, and other software makers now bundle a pre-amp with some programs.

THE PREREQUISITES

ONCE I HAD GOTTEN past the pre-amp roadblock, I was ready to roll. The foundation of any rock song is the drums, so I started there. At first, I used loops—short snippets of a drummer playing a beat pattern that can be sped up or slowed down to match the song's tempo. Later, I wanted a more complex sound, so I started using a sampler—software that takes a beat pattern I create and repeatedly triggers it over short recordings of individual drum sounds to play a drum track.

With the drums setting the tempo, you can move on to the rest of the song. The software lets you create scores of separate tracks, so you can add a virtually unlimited number of instruments and vocals. I played the guitar and sang, invited a friend over to play bass, and added piano and synthesizer sounds with my tiny keyboard. If you don't like a track, you can record over it or mute it while you try a different approach. One or two bad

notes? You fix them by recording over just a tiny sliver of a song.

You can cut and paste passages of music or even individual notes just like you might a bit of text in a word processor. And most software also lets you insert loops of different instruments if your playing isn't up to snuff. In short, musical talent isn't really a prerequisite.

Once I had my tracks down, it was time to get creative. The software lets you add reverb (an echo that gives recordings a livelier feel), compression (which evens out the volume of an instrument or a vocal

track), and a dozen or more other effects that tweak sounds to make them richer, deeper, or just weirder. Then came mixing. The first step is panning each track toward either the left or the right, to put the song in stereo. Then I set the volume of each track so it didn't overwhelm the others, giving the song a balanced feel.

It sounds simple, but it takes a lot of time, and the learning curve is steep. I typically spend at least 10 hours recording and mixing a three- or four-minute song. And most programs, even some scaled-down versions for relative neophytes, are written for knowledgeable professionals. For instance, the manual or help file might tell you how to add reverb, or pan to the left or right, but it won't tell you when or why you should do it. Tip: Go to Web sites such as Sweetwater.com or user forums hosted by the software manufacturers, where you'll find aspiring musicians trading tips on how to make your recordings sound professional.

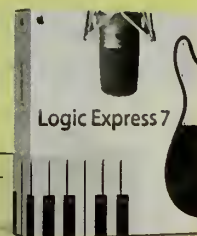
The Web is also a great place to let the world hear your songs (page 94). I post mine on a site called SoundClick, which hosts tunes for free. Anyone can stream or download them, also for free, and it has dozens of charts that rank the popularity of songs in such genres as pop, rock, and country. Truth be told, I've never broken the top 50 in any category, so I'm still as far from stardom as I was two decades ago.

That's fine with me. I know I'm going to be really big, really soon. Really. Just ask my Mom. And this time, I have the recordings to prove it. ■

BusinessWeek online To download an MP3 version of a David Rocks song go to www.businessweek.com/extras

I WANNA BE A PRODUCER

With today's music software, computers can make remarkably professional-sounding recordings.



APPLE	Its GarageBand is the easiest-to-use program on the market—provided you have a Mac. For more ambitious projects, Apple offers the \$299 Logic Express and the \$999 Logic Pro 7.
CAKEWALK	Has a wide range of offerings, from a \$40 entry-level package called Music Creator to the \$500 Sonar, which just might suffice for your next Grammy-winning song.
DIGIDESIGN	The gold standard for professional recording studios, Pro Tools will do just about anything you need. The downside: Mastering all of its rich features can take years.
SONY	Sony's Acid programs (\$40-\$350), have long been tops for making loop-based music. Acid Pro 6, due this spring, lets users add multiple software instruments, too.
STEINBERG	Its Cubase is a favorite of home musicians and pros alike, and will run on both Macs and PCs. Steinberg offers three versions, costing from \$100 to \$600.

Data: BusinessWeek

KIDS SOFTWARE

Learning Music, Yawn-Free

Engaging ways to teach today's computer-savvy kids how to compose and play. **BY ANDREW PARK**

THE IPOD GENERATION isn't just listening to music differently. It's learning about it differently, too. These days, a kid's first introduction to making music is just as likely to come on the keys of a PC as on a piano. With inexpensive "edutainment" software, children can learn to appreciate, understand, and even write music. The best programs use animation and games to turn drab music theory into engaging fun.

An excellent example is the new Groovy Music series from Sibelius. The British company is known for its sophisticated composition and instruction software, but don't let Groovy's pro pedigree intimidate you. Groovy Music is a colorful and charming introduction to important musical concepts for 5- to 11-year-olds.

Each of the three Groovy programs (\$69 apiece) is divided into two parts. The "Explore" section uses a variety of games

to teach key ideas. In the first lesson, for example, to learn the difference between a trumpet and a piano, kids match melodies they hear to pictures of the instruments. Then, in the "Create" section, they use those instruments and scores of other beats and sounds to compose their own songs. As the music is played back, an animated character saunters across the screen to represent tempo and duration. Another screen displays the notes on a staff to introduce kids to reading music.

With Music Ace Deluxe from Harmonic

Vision (about \$50), your child gets 36 lessons beginning with a primer on the musical staff and moving through complex concepts such as harmony and time signatures. A cartoon conductor named "Mae Stro Max" delivers each lesson followed by games that test what has been taught.

Music Ace is popular with schools wanting to cover beginning theory. Deluxe, aimed at ages 8 and up, combines the best of the two previous versions, including a digital "Doodle Pad" for writing simple compositions. The only downside: Primitive graphics like smiling notes and bouncing balls might not engage kids used to sophisticated video games.

If you really want to grab kids' attention, throw out the lesson plans and let them play. The beauty of software for making and mixing digital music is that no skill is required. One popular program, GarageBand, part of Apple Computer's \$79 iLife suite, is now in many classrooms because it also allows students to see how musical sounds are combined to make songs.

But GarageBand works only on Macs and it's loaded with advanced features.

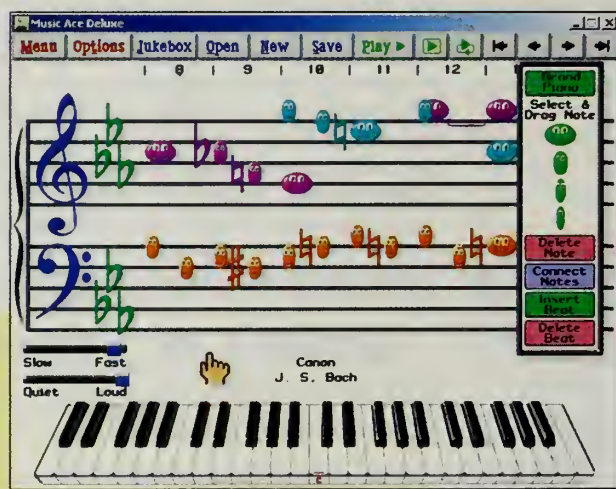
THEORY LESSON
Many schools use Music Ace Deluxe

Fortunately, Sony just came out with a pair of fine kids' music creation programs for PCs: Super Duper Music Looper for ages 6 to 11 and Jam Trax for 11 and up (less than \$20 each). Their clean design makes them a snap to master, but they otherwise work just like Sony's top-selling professional editing software, Audacity. Like Acid, they come with hundreds of loops, pre-recorded musical riffs, and beats played on a variety of instruments. To create a song, kids simply layer together loops, or plug a microphone, guitar, or keyboard into their PC. Once they've saved a song, they can export it to a portable music player or e-mail it.

Critics question the educational value of looping software, but a motivated kid can learn a lot just by controlling and visualizing sound for the first time. For parents, beats listening to them bang on drums.

LET THEM EDUTAIN YOU

Fun, easy-to-use software can supplement a child's exposure to music at school.



TITLE	Harmonic Vision Music Ace Deluxe	Sibelius Groovy Shapes	Sony Super Duper Music Looper and Jam Trax
PRICE	\$46 - \$80	\$59 - \$69	\$14 - \$20
THE LOWDOWN	Primitive graphics are the only weakness of this thorough introduction to beginning music theory	Engaging and intelligent tools that teach key concepts and then help kids compose songs	A simple way for children to create music on a PC, but the educational value is limited

BusinessWeek weekend For more on this story, watch BusinessWeek Weekend (check local listings) or go to businessweekweekend.com

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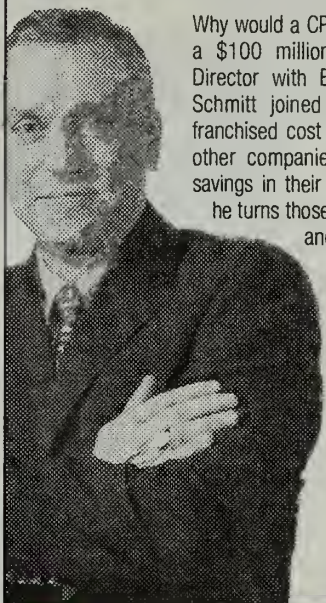
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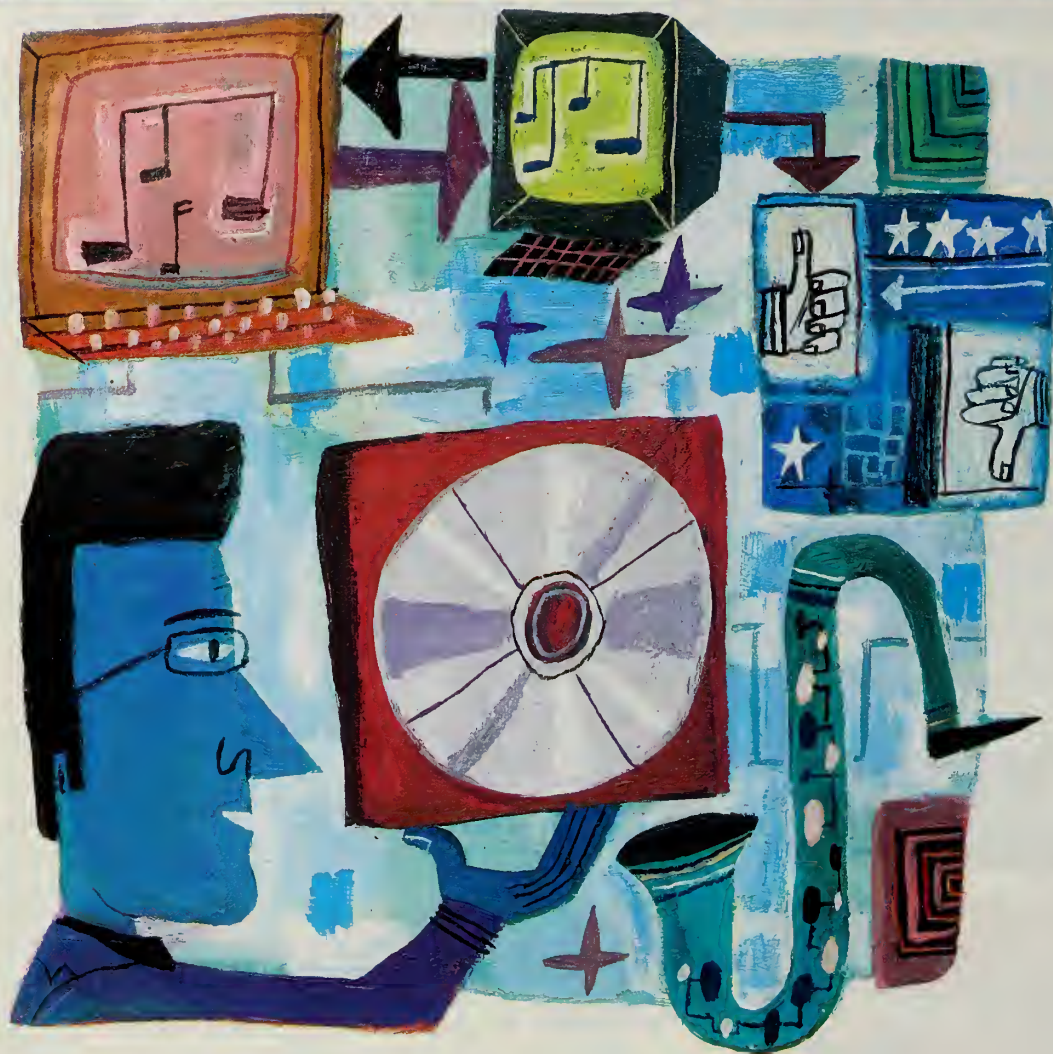
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PUBLISHING

Singing Beyond The Shower

With Web outlets like these, your music can travel farther than you've dreamed. **BY JAMES K. WILLCOX**

IN THE 1990S, SAM PINOLA played in a band, toured the country in a van, and dreamed of rock stardom. Today music is more of a hobby for the 32-year-old project coordinator at William C. Cox, a construction company outside Philadelphia.

With a full-time job, a mortgage, and a girlfriend who will soon be his wife, Pino-

la no longer tours. But more people may be hearing his music than ever before, thanks to the Web page his band, The Support Group, created on myspace.com. "We all now have day jobs, so we can't just jump into a car and drive to New York to play a gig," Pinola explains. "Having a MySpace page has helped expose our music to fans we wouldn't previously have been able to reach."

First, the Digital Revolution gave us inexpensive recording gear and easy-to-use software helping amateur musicians record professional-sounding works. Now, the Internet has democratized how music is distributed and even sold. Leading the charge are social networking sites like MySpace, Friendster, and Facebook, which have built communities around music and other shared interests. Members appreciate recommendations from friends on the sites, notes Rishon Blumberg, a partner at Brick Wall Management, a traditional music company that handles Marc Broussard, Citizen Cope, and other artists. "Putting an artist on MySpace is like opening a store in a heavily trafficked shopping mall," he says. Here are some of the best places to get your own music heard:

MYSPACE In the 13 months since its launch, MySpace has emerged as the mack daddy of social networking sites, boasting 54 million members and more monthly page views than eBay, Amazon.com, says comScore Media Metrix. While Friendster has been around longer, MySpace's easy-to-use interface and early focus on music and blogs help

propel it past its competitor.

Whether you've recorded a few tunes in your basement or a major label is heralding you as the next big thing, having a MySpace page is de rigueur, almost like owning a ripped pair of jeans and a leather jacket. With each account, you can post bios, blog entries, tour info, and photos. You can upload up to four songs, and there's a counter that tracks plays and downloads. MySpace recently launched a beta version of a video section, and it has promised a more robust instant-messaging system soon. Ban love the site both for its active, vocal membership, and for the ease of finding other bands. The URL is always myspace.com/thebandname.

GARAGEBAND.COM Born in the dot-com gold rush, GarageBand.com (not to be confused with Apple Computer's GarageBand software) was co-founded by ex-Talking Head Jerry Harrison among others. Eschewing the major-label system, the site awarded top-rated independent bands \$250,000 recording contracts. 1

business model wasn't sustainable, and the Web site went dark in 2002. Then GarageBand was relaunched by former employees armed with fresh financing committed to helping independent musicians gain exposure.

The heart of the service is now a review-based process: You have to rate 30 other songs before you can submit one of your own. GarageBand uses a proprietary algorithm to rank songs based on feedback it receives from the community, with the idea that better songs will get more reviews, move up the site's charts, and perhaps garner so much attention that the artist will be offered a publishing deal. For those of us with lofty goals, the site is still a great way to get constructive feedback. It promotes top-ranked songs on college and Internet radio stations, including WFN Music. You can also create and distribute podcasts.

CD BABY Have you ever wondered if smaller artists can get music up on iTunes and other services? Thanks to CD Baby, the answer is yes. The site has earned a devotion that borders on the cultish. Want to sell your CD? Just pay a fee of \$35 to set up an account, set your price, and wait for orders to roll in. CD Baby gets a cut of \$4 per disk, a more equitable split for the artist than any traditional retailer. Need a bar code so your CD can get scanned? CD Baby will give you one for \$20. The company warehouses all its artists' CDs, ships them promptly, handles all the financial transactions, and even sends your customers endearingly thank-you notes. Since its launch in 1998, CD Baby has paid out more than

GEAR UP

M-AUDIO PODCAST FACTORY \$150

m-audio.com

Creating your own podcast is a great way to get your music heard. M-Audio's Podcast Factory bundles everything you'll need to record, edit, and distribute a broadcast-quality podcast. The basic package includes a USB audio interface, dynamic microphone with stand, and the

necessary software. The deluxe version, shown here, cranks it up a notch with two higher-quality condenser mics and the ability to record interviews using voice-over-Internet phone calls.



\$23 million to independent artists.

Now the company is helping independent artists get their music placed on download venues such as iTunes, Rhapsody, Napster, AOL's MusicNet, and Yahoo! Music. You keep all rights to your music, you don't have to pay a start-up fee, and you get 91% of the artist's share of the sale (CD Baby gets the other 9%), which they provide one week after they receive payment. The one caveat: CD Baby insists on being the exclusive dis-

tributor of your digital music. But with 30 days' notice, you can always cancel out.

TAGWORLD Newcomer TagWorld is like MySpace on steroids, allowing members to attach "tags," or keywords, to photos, blogs, and even songs so others can find them more easily. Anytime you come across a new artist you like, just click the Add to My Tunes button and that song will instantly be available on your own page. While MySpace lets you keep just one song on your personal profile page, on TagWorld you can create entire playlists, tagged by genre, which will begin streaming whenever someone visits you. Your My Tunes selections are online so you can listen wherever you browse.

You can also create a multipage Web site using drag-and-drop modules for including music, videos, blogs, etc. And you can set the "permissions" for how others access the songs that you have uploaded and tagged. You can monitor how many times your song gets played, how many people have added it to their My Tunes list, and even the age and gender of your fans. While MySpace has a four-song limit, on TagWorld you can upload as many songs, photos, and videos as your 1 GB of storage will hold.

PANDORA This site is part of the aptly named Music Genome Project. Pandora and its team of 35 musician-analysts listen to songs in every genre, breaking them down into 400 attributes ranging from melody and harmony to rhythm and lyrical content. That lets Pandora create playlists of tunes that are genetically similar, if you will, to the songs you like. Wanting to test its limits, I selected a disparate group of artists, including Richard Thompson, Fountains of Wayne, and The Who. Pandora sent me Echo and the Bunnymen, Free, and Yo La Tengo—pretty impressive.

The site is free with ads, or \$36 a year without, and accepts submissions from unsigned artists, once an audition is cleared. If chosen, your song might get sandwiched between two of your favorite artists, which means the person streaming your song may be strongly predisposed to like your music. For an artist, that's as good as it gets. ■

SITES THAT EXPAND YOUR REPERTOIRE

After creating your masterpieces, posting them on these sites might bring you an audience

WEBSITE	CD Baby cdbaby.com	GarageBand GarageBand.com	MySpace myspace.com	Pandora pandora.com	TagWorld tagworld.com
PRICE	Free for digital distribution	\$99 for unlimited hosting	Free	Free (with ads)	Free
TO DOWN	After you have set up an account (\$35) to sell CDs, you can get free digital distribution of your music to sites such as iTunes, Napster, and Rhapsody	Site is free to join, and for different fees you can create Web pages, host MP3s, and manage mailing lists. Popular songs earn chart rankings.	Offers easy-to-build home pages you can personalize with favorite songs, including your own, and a community of more than 50 million "friends."	Helps members discover new music that matches their tastes. Music from unsigned artists must go through an audition process to be included.	Offers drag-and-drop modules to help you build a personal Web site, not just a Web page, and backs it up with one gigabyte of storage per user.



BY GENE G. MARCIAL

WEB SHOPPERS, PLUS CHINA AND INDIA, HAVE **UPS** SOARING.

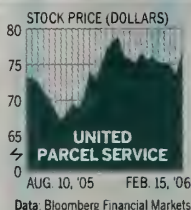
PNC FINANCIAL PROFITS AS MERRILL LYNCH BUYS BLACKROCK.

A NEW MIGRAINE REMEDY COULD SOON PAY OFF FOR **POZEN**.

UPS Delivers the Goods

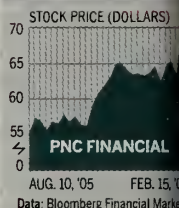
UNITED PARCEL SERVICE (UPS) may soon bring shareholders a nice surprise package. The world's largest express company, with an AAA credit rating, is rich in cash and profits. So it might look as if its stock, up from 66 in September to 75 on Feb. 15, already reflects these goodies. Not by a long shot, says Stephen Leeb, who heads Leeb Capital Management, which owns shares. He expects the stock to hit 100 in 18 to 24 months because of its "super-growth prospects." Not only does UPS dominate the U.S. market, where it picks up 75% of its revenues, but it's also building up in China and India. The global delivery market is estimated to be worth more than \$100 billion a year. In the U.S., explosive growth in Internet retailing is also adding to UPS volume. But the still-uncounted big plus, argues Leeb, will come from Asia, where its competitive edge may even be greater. UPS operates 560 airplanes and 88,000 ground vehicles worldwide. "We can't think of any other company that can benefit as strongly from China, India, and the Internet," Leeb notes. Jim Corridore of Standard & Poor's, who rates UPS a four-star buy (five is tops), expects overseas volume and revenues to rise some 20% this year, aided by robust export activity from Asia. Higher oil prices won't crimp operating earnings, he says, because UPS adds fuel surcharges to deliveries. At 19 times Corridore's 2006 profit estimate of \$4 a share (vs. 2005's \$3.47), the stock is trading at the low end of its price-earnings ratio range of 19 to 30 over the past five years.

GETTING UP TO SPEED



an aftertax gain of \$1.6 billion. That gives it the flexibility, says PNC, to repurchase shares. Gary Townsend of Friedman, Billings, Ramsey Group figures the deal could boost PNC's pro forma earnings to as much as \$5.62 a share in 2006 and \$6.22 in 2007, up from his pre-deal forecasts of \$5.12 and \$5.67, respectively. The stock trades at 12 times his new 2006 estimate. PNC is worth 74 a share on a sum-of-the-parts valuation, says Townsend, who rates the stock "outperform."

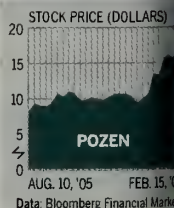
OFF AND RUNNING



Pozen's Trexima: Going to Market with Glaxo

ATENTION, MIGRAINE SUFFERERS: Help is on the way from Pozen (POZN) in the form of Trexima, a new drug for severe headaches that analysts claim is more effective and faster-acting than GlaxoSmithKline's \$1 billion a-year blockbuster Imitrex. It's expected to get U.S. approval in the second quarter. Imitrex' patent expires in 2009, and Pozen has teamed up with Glaxo to market Trexima in the U.S. It will focus on Trexima once it gets O.K.'d, says Pozen CEO John Plachetka. Joshua Schimmer of investment firm S.G. Cowen expects the stock to outscore the market once the new drug is launched. It has already been on a tear, leaping from 8 in August to 17 on Feb. 15. Schimmer figures Pozen will earn 50¢ a share in 2009 and \$1.55 in 2010. Nadav Hazan of SunTrust Robinson Humphrey says Pozen should get \$20 million from Glaxo once Trexima is approved, on top of the \$60 million it has already received. Through 2009, Hazan figures Pozen will get a 6% royalty on U.S. sales of up to \$600 million, and 17% above that. In addition, Pozen has an arthritis drug in clinical trials, which the company claims is a lot safer than its rival painkillers. ■

A GIANT LEAP



BlackRock's Sale Will Line PNC's Pockets

PNC FINANCIAL SERVICES GROUP (PNC) is a big winner in the deal between Merrill Lynch and investment manager BlackRock announced on Feb. 15. Before the agreement, PNC owned 70% of BlackRock's shares and had 84% of the voting rights. PNC shares have shot up from 55 in October, when rumors first swirled that it might cut its BlackRock stake, to 69 on Feb. 15. Merrill edged out Morgan Stanley in making a deal with BlackRock (page 36). PNC halved its BlackRock holdings, to 35%. PNC says it will record

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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Personal Business Figures of the Week

STOCKS



COMMENTARY

After a subdued start to the trading week, markets rallied on Feb. 14, turning Valentine's Day into a lovefest. The Dow closed above 11,000, while the S&P 500 neared a new high. The next day, Fed Chairman Bernanke went before Congress to discuss the economy. His message—rate hikes will continue—set stocks back, though by the end of the day they had recovered.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	FEB. 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1280.0	1.1	2.5	5.8
Dow Jones Industrials	11,059.0	1.8	3.2	2.0
NASDAQ Composite	2276.4	0.4	3.2	9.0
S&P MidCap 400	767.9	0.0	4.0	15.6
S&P SmallCap 600	373.9	0.4	6.6	13.7
DJ Wilshire 5000	12,867.5	0.9	3.0	8.0

SECTORS

	FEB. 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	754.6	0.0	1.7	4.8
BW Info Tech 100**	385.8	0.4	1.4	5.9
S&P/BARRA Growth	607.1	0.8	1.8	4.5
S&P/BARRA Value	669.2	1.5	3.3	7.1
S&P Energy	385.1	-3.8	3.3	19.8
S&P Financials	433.9	2.1	1.7	5.6
S&P REIT	164.0	2.0	7.2	18.0
S&P Transportation	264.4	4.2	5.8	17.8
S&P Utilities	160.6	0.3	0.6	8.4
GSTI Internet	195.7	-1.9	-4.6	20.8
PSE Technology	872.2	0.1	4.3	14.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	FEB. 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONTH
S&P Euro Plus (U.S. Dollar)	1586.5	0.5	5.0	13
London (FT-SE 100)	5791.5	1.2	3.1	14
Paris (CAC 40)	4934.1	0.8	4.6	22
Frankfurt (DAX)	5764.4	1.7	6.6	30
Tokyo (NIKKEI 225)	15,932.8	-2.1	-1.1	36
Hong Kong (Hang Seng)	15,423.3	0.3	3.7	10
Toronto (S&P/TSX Composite)	11,557.3	-1.5	2.5	20
Mexico City (IPC)	18,169.2	-1.3	2.1	32

FUNDAMENTALS

	FEB. 14	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.78%	1.81%	1.93%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.0	17.9	20.6
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	14.6	16.4
First Call Earnings Revision*	-1.59%	-1.42%	-0.80%

TECHNICAL INDICATORS

	FEB. 14	WEEK AGO	YEAR AGO
S&P 500 200-day average	1226.5	1223.7	Positi
Stocks above 200-day average	65.0%	63.0%	Neut
Options: Put/call ratio	0.71	0.80	Positi
Insiders: Vickers NYSE Sell/buy ratio	4.05	4.02	Negati

BEST-PERFORMING GROUPS

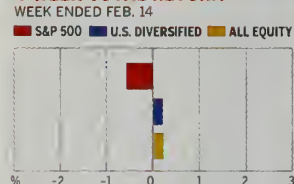
	LAST MONTH %		LAST 12 MONTHS %
Railroads	16.4	Railroads	53.8
Steel	16.0	Oil & Gas Equipment	51.3
Constr. Materials	15.5	Divsfd. Metals & Mining	51.0
Agricultural Products	14.2	Oil & Gas Exploration	46.8
Constr. & Farm Mchnry.	10.3	Oil & Gas Refining	46.7

WORST-PERFORMING GROUPS

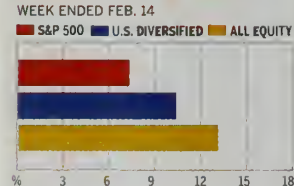
	LAST MONTH %		LAST 12 MONTHS %
Internet Software	-17.6	Automobiles	-38.1
Internet Retailers	-16.6	Photographic Products	-2.1
Oil & Gas Refining	-14.2	Auto Parts & Equip.	-2.1
Tires & Rubber	-13.8	Divsfd. Commercial Svcs.	-1.1
Homebuilding	-12.0	Home Entrnrmnt. Software	-1.1

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	3.8	Latin America	62.0
Communications	2.8	Precious Metals	45.5
Pacific/Asia ex-Japan	2.3	Diversified Emerg. Mkts.	39.4
Diversified Emerg. Mkts.	2.1	Natural Resources	34.2
LAGGARDS		LAGGARDS	
Natural Resources	-5.1	Domestic Hybrid	6.2
Japan	-2.0	Large-cap Blend	7.7
Utilities	-1.6	Large-cap Value	8.0
Large-cap Growth	-1.5	Miscellaneous	8.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Oberweis China Opps.	12.0	ProFunds Ultra Japan Inv.	90.7
ProFds. UtlTelcmms. Inv.	11.2	ING Russia A	89.0
Eaton Vance Grtr. India A	9.8	iShares MSCI Brazil Idx.	71.2
Janus Asp. Life Scncs. Srv.	9.7	T. Rowe Price Latin Am.	70.0
LAGGARDS		LAGGARDS	
Ameritor Investment	-14.3	Ameritor Investment	-68.4
American Heritage	-11.1	American Heritage Grth.	-42.9
Rydex Commodities H	-10.2	Frontier MicroCap	-29.6
ProFunds Internet Inv.	-10.0	American Heritage	-27.3

INTEREST RATES

KEY RATES

	FEB. 15	WEEK AGO	YEAR AGO
Money Market Funds	4.01%	3.99%	1.98%
90-Day Treasury Bills	4.55	4.51	2.56%
2-Year Treasury Notes	4.69	4.63	3.33%
10-Year Treasury Notes	4.60	4.59	4.10%
30-Year Treasury Bonds	4.57	4.68	4.45%
30-Year Fixed Mortgage †	6.25	6.19	5.41%

†BancQuote, I

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.84%	4.4%
Taxable Equivalent	5.49	6.2
Insured Revenue Bonds	3.96	4.4
Taxable Equivalent	5.66	6.3

THE WEEK AHEAD

LEADING INDICATORS Tuesday, Feb. 21, 10 a.m. EST » The Conference Board's January index of leading economic indicators probably rose 0.5%. That's the median forecast of economists surveyed by Action Economics LLC. Lower initial jobless claims and higher stock prices should help the January reading. In December, the index edged up 0.1%.

FOMC MINUTES Tuesday, Feb. 21, 2 p.m. EST » The Federal

Reserve's Open Market Committee releases the minutes to its Jan. 31 monetary policy meeting, the last of Alan Greenspan's tenure. Fed watchers will scour the notes for clues on how close the central bank is to halting its rate hikes.

CONSUMER PRICE INDEX Wednesday, Feb. 22, 8:30 a.m. EST » Consumer prices for goods and services most likely increased by 0.4% during January on a rebound in crude oil prices.

The index ticked down by 0.1% in December. Excluding food and energy, January prices are expected to have posted a 0.2% gain for the fourth consecutive month.

DURABLE GOODS ORDERS Friday, Feb. 24, 8:30 a.m. EST » Durable goods orders most likely pulled back by 1% in January. During December, orders jumped 1.8% on strong gains in computers and machinery.

The BusinessWeek production index moved up to 270 for the week ended Feb. 4, up 13.4% from a year ago. Before calculation of the four-week moving average, the index moved to 271.2.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extr

The Companies

This index gives the starting page for a story or feature with significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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And Baby Makes...a Market

THE BABY BUSINESS How Money, Science, and Politics Drive the Commerce of Conception

By Debora L. Spar; Harvard Business School Press; 298pp; \$26.95

The Centers for Disease Control & Prevention reports that 12% of U.S. women between the ages of 15 and 44—some 7.3 million in total—experienced infertility in 2002. In addition, an estimated 30% of adult men are infertile. That means one in every eight couples is unable to conceive children by natural

means. Behind that number is a lot of heartbreak, yearning, and a huge market: Fertility clinics in the U.S. collected \$2.7 billion in 2002.

It's a market unlike any other, however, because no one wants to acknowledge its existence. Baby selling may be outlawed in every nation, yet every day, in every country, money and the means for having children change hands with little government oversight. "When parents buy eggs or sperm; when they contract with surrogate [mothers]; when they choose a child to adopt or an embryo to implant, they are doing business," writes Debora L. Spar, a professor at Harvard Business School. "Over the past 30 years, advances in reproductive medicine have indeed created a market for babies."

Spar dissects this thriving industry in her provocative *The Baby Business: How Money, Science, and Politics Drive the Commerce of Conception*. The book, though well worth reading, is somewhat unnerving in that it brings matter-of-fact business analysis to the creation of children, surely one of the most unbusinesslike of subjects. Still, it is a valuable if occasionally dry look at a sector of the economy whose customers are usually far too emotional to clearly assess just what it is they are paying for.

Spar starts with a history of the baby-making business, going back as far as the Old Testament story of Jacob's wife. After failing to conceive she sent Jacob to sleep with her maid and adopted the resulting child. There were few other means for coping with infertility until the 1920s, when the hormone estrogen was discovered and mass-produced. By the late 1930s, most major U.S. cities had at least one fertility practice administering estrogen. After a woman using hormones gave birth to quintuplets in 1970, demand soared.

The industry really took off in 1978 with the birth of Louise Brown, the first test-tube baby. She was created by in vitro fertilization (IVF), in which an egg is extracted and combined with sperm in a test tube. The fertilized egg is then implanted in the mother's womb. An international outcry

ensued, typified by the reaction at the time of biologist Leon Kass (who went on to chair President George W. Bush's Council on Bioethics): "This blind assertion of will against our bodily nature...can only lead to self-degradation and dehumanization." In the wake of Louise's birth the federal government set up a commission to figure out what to do about IVF, but it never issued any recommendations. Instead by 1983 some 150 babies had been conceived in vitro, and the furor had disappeared.

Today, desperate couples go through round after round of IVF, at an average cost of \$12,400 per try, even though the average success rate is only 25% and drops as low as 9% if the woman is over 40. High cost and poor results would be a death knell for most businesses, but in the emotional world of infertility, couples often keep paying until they run out of money; very few run out of will. Those who do give up can turn to adoption along with about 120,000 other U.S. families each year, shelling out up to \$35,000 per child.

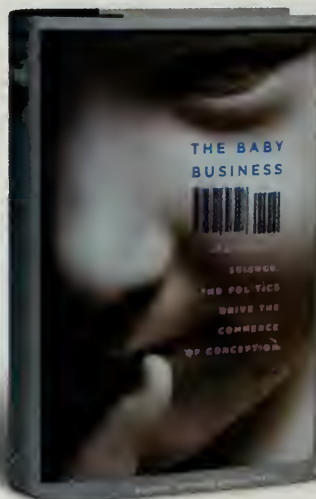
The most disquieting parts of the book are those chapters that detail some very advanced reproductive technologies. Doctors can now remove one or two cells from a two-day-old embryo in a test tube, tell the parents its gender and test for certain genetic defects. The parents then choose which embryos they want implanted. Scientists are also only steps away from cloning a human.

Of course, the fact that couples can use such high-tech methods doesn't mean that many will. As one fertility expert says: "Most people would rather have sex." Then again, the desire to have one's own biological offspring can be insatiable. Spar quotes an infertile woman who says cloning may not be right for everyone, but "if the only way for a person to have a child of their own is to do this, and if they are willing to take a chance then they should be able to."

Costs are high, results are poor, and laws are few. Welcome to the fertility biz

Spar raises some troubling ethical issues surrounding the baby-making machinery. Science is handing us the ability to choose the method of conception and its likely results, yet there is little public debate and even less regulation surrounding these choices. "We can moralize about these developments if we desire," she concludes, "or we can plunk into the market that desire has created, imagining how we can shape our children without destroying ourselves." ■

—By Catherine A.



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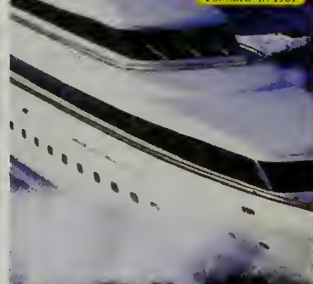
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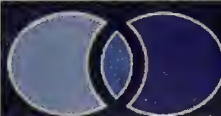
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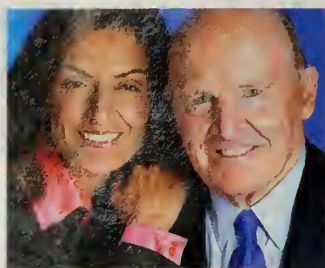
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Ideas The Welch Way

BY JACK AND SUZY WELCH

Knowing When to Fold 'Em

You make the case that leaders should be candid. But what would you advise a middle manager whose leaders place challenging questions in the "parking lot" and tend to stunt (or end) the careers of people who keep asking them?

—Anonymous, Minneapolis

Before answering, can we ask you an awful question? With all due respect, is the problem possibly you? Now and again, leaders ignore "challenging questions" because they're more annoying than constructive, and the people asking them are, too.

If that's you, and you have the self-awareness to accept that unpleasant fact, our only suggestion is to redirect your energies toward real work, or *you'll* be in the "parking lot" before long.

But let's assume that's not you, and that your questions are meaningful, if maybe a bit irritating. In that case, you're in one of two situations, neither of them optimal but both actionable.

It could be you have a boss problem. That is, your boss is something of a jerk and can't handle open dialogue, particularly if it is potentially contentious. In that case, if you like your job well enough, your best bet is to wait it out for a while. In time, most good organizations identify stultifying idea-blockers and move them elsewhere or out.

On the other hand, you could have a culture problem. Maybe the leadership in general does not relish constructive curiosity. In that case, you have a question to ask yourself: Does your job have enough upside to live with this overarching downside?

About 12 years ago a friend of ours became marketing director of a consulting firm. Since then the firm has fared pretty well, but its three partners have remained steadfastly opaque. Employees never know what the partners are thinking about the firm's direction or how they rate each person's performance. The result: a sense of constant anxiety and confusion.

Our friend, however, has no plans to give up the good money and the short commute. The work is interesting enough, he says, and he likes most of his colleagues. Yes, the leadership's lack of candor drives him nuts ("intermittently," as he puts it), and he feels that it has significantly hindered the firm's growth. But, he says, "I've traded an O.K. quality of work for a great quality of life."

Like our friend, you can make peace with your situation. Or if you know you have reached your limit, you can look for an-

other job. To hang around and complain under your breath is fast track toward probably the worst workplace hell imaginable: victimhood. People with this self-infliction conceive of themselves as vanquished heroes. Their bosses see them as energy-sapping bores. Do not go there!

Only you know what choice you will ultimately make. Just be sure you make it—one way or another.

For four years I ran a single store in a large national retail chain, but I was recently promoted to oversee multiple stores. I am finding, however, that I still worry more about the performance of my old store than what's going on at all my stores.

—Jerry Martellaro, Huntington Station, N.Y.

You've nailed it, and bravo for that. Most people in your position don't have the self-confidence to realize they have fallen into one of the most common traps of moving up, namely, taking on a new job with enthusiasm but keeping one foot in the old. With your promotion, two people got new jobs: you and your replacement. As a leader, your task is to unleash the innovative ideas you both have. Neither of you can do that if you are spending your energy "going home" all the time. Instead, get to know your expanded world and raise the bar for all your stores.

How? Start by thinking of your stores as labs. Yes, they all do roughly the same thing, but certainly some of them have methods or procedures that are more effective. Your job is to spread those best practices. You want everyone in all your stores talking about each other's best ideas and improving them. That will add more value than looking over someone's shoulder.

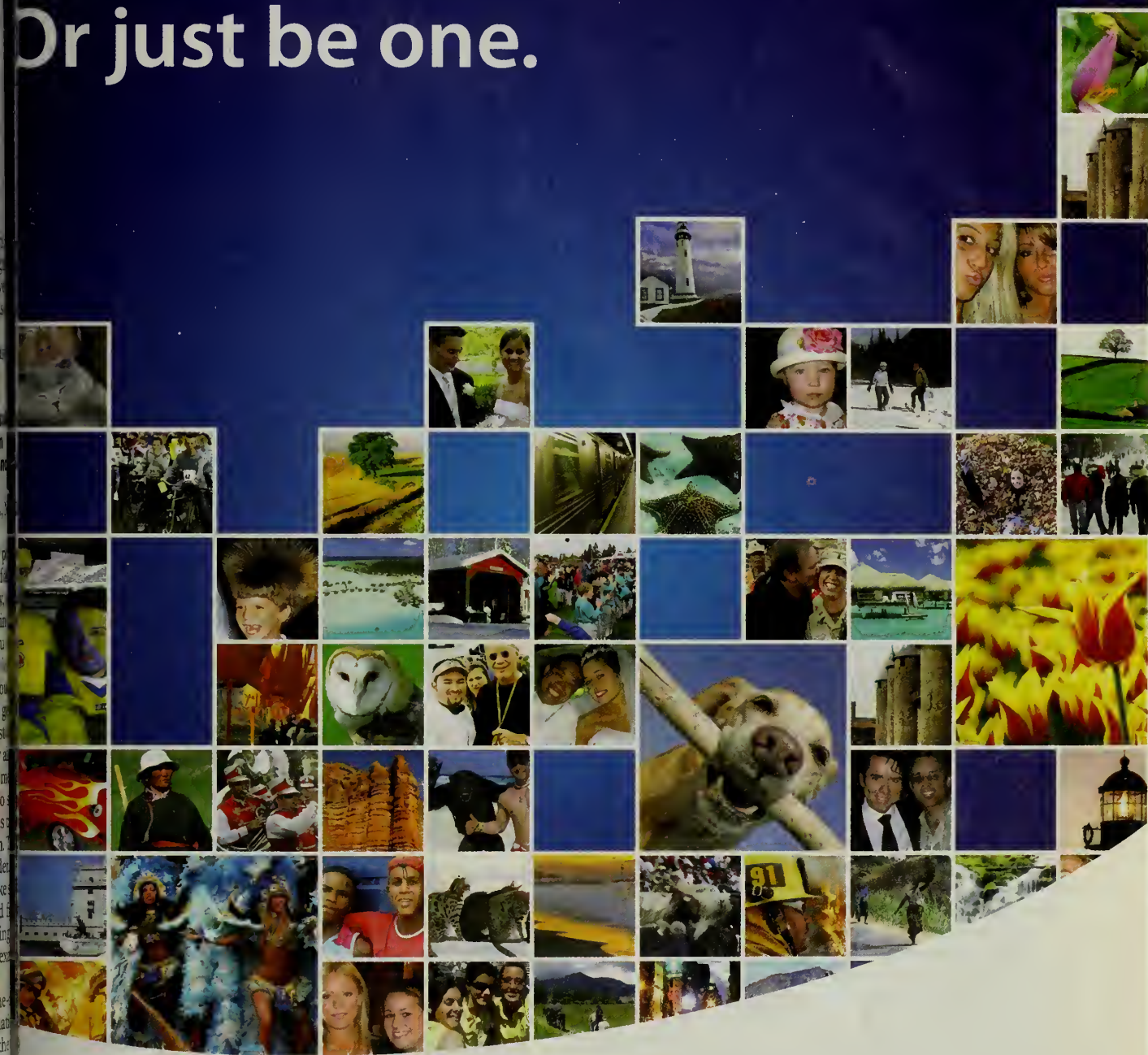
Transparency is another great tool to raise the bar. Make sure to share the comparative metrics of every store, ranked from best to worst. Such clarity works wonders. It's motivating top-performing stores and signals to poor performers exactly where they can look for more effective approaches.

A final way to raise the bar and avoid the "foot-in-the-door" trap is to conduct regular, rigorous performance evaluations. That allows you to reward managers who demonstrate the values you have laid out, coach your middle group, and weed out underperformers. The outcome: higher standards for all.

Your new job is bigger than your old one. More important, it's different. You've got a lot to do, but it doesn't include what you used to do. Leave that to your replacement, who can busy reinventing the "perfect situation" you left behind. ■

*Jack and Suzy Welch are the authors of the international best-seller **Winning** (HarperCollins, 2005). They are eager to hear about your career dilemmas and challenges at work and look forward to answering your questions in future columns. Please e-mail them at thewelchway@businessweek.com.*

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WEBSHOTS



Ideas Outside Shot

BY REPRESENTATIVE BARNEY FRANK

When the Bounty Isn't Shared

Adlai Stevenson, the story goes, was once congratulated after a speech by a woman who told him it would get him the votes of all “thinking people.” “That’s wonderful,” he is said to have replied, “but unfortunately I need to get a majority.” It may have been Stevenson’s propensity for making such amusingly deprecatory comments about voters that kept him from winning

that majority in his two 1950s Presidential bids. But Stevenson’s observation is relevant today to those of us in the minority who believe the most serious problem America faces is excessive economic inequality.

“Excessive” is the operative word here. Inequality is not a bad thing in a free market economy; indeed, it’s essential if we’re to benefit from the incentives and efficiencies that make the market so effective a producer of wealth. But left entirely to its own devices, the free market will produce more inequality than is necessary for efficiency or a healthy society. That’s especially true in an economy marked by globalization, the increased use of information technology, and the rapid flow of capital across borders. Alan Greenspan said as much when he told Congress’ Joint Economic Committee in 2004 that nearly all the benefits of recent productivity growth were going to corporate profits, resulting in “a marked fall” in employees’ share of the gains.

Nothing in the past two years has alleviated that problem. Real wages for the average worker have eroded, and health and pension benefits have faded. Meanwhile, corporate profits and pay for the top 2% of the population have soared.

For many of us, this is morally objectionable because it means that a large majority of people live at a lower standard of living than we think Americans ought to. But the counterargument, supported by many in Corporate America, is that focusing on inequality is a mistake, so long as the absolute level at which the majority lives is acceptable. So any reduction in inequality can only be won by a majority that includes people who do not share my values-based objections.

That’s why business must understand that it too benefits by reducing inequality. In testimony last summer, Greenspan lamented the “growing evidence of antiglobalization sentiment and protectionist initiatives,” which threatened economic flexibility. And he agreed when I suggested that this is not simply a case of crankiness but a broad public reaction to the perception of inequality he cited in 2004. Indeed, when people see their real wages stagnating or falling, health benefits threatened, and pensions insecure, they’re unlikely to support

policies that help the economy at their own expense.

Look overseas. In 2004, India’s ruling Bharatiya Janata Party (BJP) called elections in a campaign based on overall economic growth that had exceeded expectations with the slogan “India Shining.” But with hundreds of millions of ordinary Indians feeling they had not shared in the benefits of economic reform, voters’ response was essentially “shine this,” and the BJP lost. More recently, Latin American voters have backed leaders hostile to deregulation, globalization, and economic flexibility.

So it’s important for business leaders to understand that overall gross domestic product growth is not enough to win political support for the tax code changes and curbs on public

spending they support. This was brought home to me at a dinner I attended last month at the World Economic Forum in Davos, where a leader of a large financial institution voiced frustration with the average American’s lack of support for globalization. “After all,” he said, “a recent study by the Institute for International Economics showed that globalization adds a trillion dollars year in value to the American economy,” which, he noted, was worth \$9,000 a year to the average American family. The problem, of course, is that the average American hasn’t seen that \$9,000. Instead, many of them believe—resentfully—that corporate executives have been keeping it all for themselves.

Therefore, it’s time to make a deal. I am prepared to help persuade my fellow liberals that many of the public policies they have been resistant to, or skeptical of, are in the national interest, if those in the business community work with us to ensure that the bulk of Americans get a larger share of our increased wealth. Our nation has both the resources and the intellect to implement public policies that diminish inequality so that it does not become socially corrosive, without reaching the point where that diminution threatens the needs of the capitalist system. Is Big Business ready to come to the table? ■

Barney Frank, a member of Congress since 1981, is ranking Democrat on the House Financial Services Committee.

Of course globalization is a tough sell if it only benefits the top 2% of Americans

